Supreme Court, U.S.
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No. 95-

In The
Supreme Court of the United States

OCTOBER TERM, 1995

LOWSLEY-WILLIAMS AND COMPANIES, ET AL.,
PETITIONERS

v.

RAYTHEON COMPANY,
RESPONDENT

On Petition for a Writ of Certiorari to the
California Court of Appeal,
First Appellate District, Division Five

PETITION FOR A WRIT OF CERTIORARI

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153 pp

QUESTION PRESENTED

Are Fourteenth Amendment Due Process rights violated when, simply because a policyholder has sued its insurers, and without any inquiry into the reasonable possibility of the suit's success, the State revokes the insurers' right to defend and imposes default judgments unless they either relinquish their right to continue operating as surplus line insurers or post multi-million dollar bonds?

RULE 14.1(b) LIST OF PARTIES

Petitioners:

Underwriters at Lloyd's, London, Syndicate Nos.:

056
090
109
190
219
231
263
279
620
650
661
918
987
989

London Market insurance companies:

Allianz International Insurance Co., Ltd.
CAMAT per C.U.A.L. Underwriting Agency
Ancon, UK
Bermuda Fire & Marine Insurance Co. Ltd.
British National Insurance Co. Ltd.
Brittany Insurance Ltd.
CNA Re
Compagnie Europeenne D'Assurances Industrielles S.A.
Dominion Insurance Company
Folksam International
Generali

Heddington Insurance Ltd.
Ludgate Ins. Co. Ltd.
Sovereign Marine & General Insurance Co. Ltd., No. 12, A/C
Sovereign Marine & General Insurance Co. Ltd, "C" A/C
Sovereign Marine & General Insurance Co. Ltd.
St. Katherine Insurance Co.
Storebrand Insurance Co. Ltd.
Stronghold
Taisho Marine & Fire Insurance Co. Ltd.
Tokio Marine & Fire Ins. Co. Ltd.
Turegum Insurance Company
Yasuda Fire & Marine Ins. Co. Ltd.
Zurich International
Zurich, Bermuda c/o Turegum Ins. Co.*/

Respondent:

Raytheon Company

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*/ Lexington Insurance Company was not "a party to the proceeding in the court whose judgment is sought to be reviewed," but remains a party to the proceeding in the trial court.

RULE 29.6 LIST OF CORPORATE PARTIES' PARENT COMPANIES AND SUBSIDIARIES

Pursuant to Rule 29.6 of the Rules of the Supreme Court of the United States, a listing of parent and nonwholly owned subsidiaries of each of the corporate petitioners is set forth at App. 101a-111a.

TABLE OF CONTENTS

Page(s)

QUESTION PRESENTED i
RULE 14.1(b) LIST OF PARTIES ii
RULE 29.6 LIST OF CORPORATE PARTIES' PARENT COMPANIES AND SUBSIDIARIES iv
OPINIONS BELOW 1
JURISDICTION 2
CONSTITUTIONAL PROVISION INVOLVED 2
STATEMENT 2
A. The Surplus Line Insurance Market 3
B. Summary Of Facts 4
C. Proceedings Below 6
D. Why This Is A Final Judgment 9
1. The Bond Order Is Both Final And Collateral To The Underlying Dispute. 9
2. The Order Is No Less Final Because The Bond Amount Has Not Been Set. 10
REASONS FOR GRANTING THE WRIT 12
I. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT CONCERNING STATE CREATION, AND SUBSEQUENT DEPRIVATION, OF PROPERTY INTERESTS. 13
A. State-Created Property Interests In Placing Surplus Line Insurance 13
B. Deprivation Of Property Interests 15

II. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT REQUIRING AN OPPORTUNITY TO BE HEARD. 18

III. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT CONCERNING EXIGENT CIRCUMSTANCES. 19

IV. THE DECISION BELOW POSES A THREAT TO THE EIGHT BILLION DOLLAR SURPLUS LINE INSURANCE INDUSTRY. 21

CONCLUSION 24

APPENDIX A

San Francisco Superior Court Bond Order 1a

APPENDIX B

Court of Appeal Briefing Order 4a

APPENDIX C

Court of Appeal Writ Denial 6a

APPENDIX D

California Supreme Court Grant and Transfer Order 8a

APPENDIX E

Court of Appeal Opinion 10a

APPENDIX F

Court of Appeal Rehearing Denial 26a

APPENDIX G

California Supreme Court Order Denying Review 28a

APPENDIX H
California Department of Insurance
Amicus Letter Brief 29a

APPENDIX I
National Association of Independent
Insurers Amicus Letter 36a

APPENDIX J
Illinois Insurance Exchange
Amicus Letter 43a

APPENDIX K
The National Association of Professional
Surplus Lines Offices, Ltd. Amicus Letter 50a

APPENDIX L
United National Insurance Company
Amicus Letter 55a

APPENDIX M
Scottsdale Insurance Company, Evanston
Insurance Company and Essex Insurance
Company Amicus Letter 60a

APPENDIX N
The Institute Of London Underwriters
Amicus Letter 69a

APPENDIX O
Prometheus Funding Corp. (f.k.a. Frank
B. Hall & Co., Inc.) Amicus Letter 74a

APPENDIX P
The American International Specialty
Lines Insurance Company Amicus Letter 80a

APPENDIX Q
The American Insurance Association
Amicus Letter 85a

APPENDIX R

The Surplus Line Association of California Amicus Letter 94a

APPENDIX S

Rule 29.6 List of Parent and Subsidiary Companies 101a

TABLE OF AUTHORITIES
CASES

Page(s)

Beaudreau v. Superior Court,
14 Cal. 3d 448, 121 Cal. Rptr. 585,
535 P.2d 713 (1975) 15, 23

Bell v. Burson,
402 U.S. 535 (1971) 12, 13, 15-20

Board of Regents v. Roth,
408 U.S. 564 (1972) 13, 15

Brown Shoe Co. v. United States,
370 U.S. 294 (1962) 10, 11

Calero-Toledo v. Pearson Yacht Leasing Co.,
416 U.S. 663 (1974) 20

Chabot v. Nat'l Securities and Research Corp.,
290 F.2d 657 (2nd Cir. 1961) 9

City of Los Angeles v. Rancho Homes, Inc.,
40 Cal. 2d 764, 256 P.2d 305 (1953) 14

Cleveland Bd. of Educ. v. Loudermill,
470 U.S. 532 (1985) 13

Cohen v. Beneficial Industrial Loan Corp.,
337 U.S. 541 (1949) 9-11

Connecticut v. Doehr,
501 U.S. 1 (1991) 15

Cox Broadcasting Corp. v. Cohn,
420 U.S. 469 (1975) 10, 11

Fuentes v. Shevin,
407 U.S. 67 (1972) 15, 18, 20

Jonnet v. Dollar Savings Bank,
530 F.2d 1123 (3d Cir. 1976) 24

McGee v. International Life Ins. Co.,
355 U.S. 220 (1957) 12

Mid-American Indemnity Ins. Co. v. King,
38 Tex. Sup. Ct. J. 1018, 1995 WL
407388 (Tex. 1995) 12
National Socialist Party v. Village of Skokie,
432 U.S. 43 (1977) 9
Ownbey v. Morgan,
256 U.S. 94 (1921) 24
Perry v. Sindermann,
408 U.S. 593 (1972) 13
Shaffer v. Heitner,
433 U.S. 186 (1977) 24
Shell Oil Co. v. Winterthur Swiss Ins. Co.,
12 Cal. App. 4th 715, 15 Cal. Rptr. 2d 815 (1993) 6
Sniadach v. Family Finance Corp.,
395 U.S. 337 (1969) 24
State Bd. of Ins. v. Todd Shipyards Corp.,
370 U.S. 451 (1962) 17
State of South Dakota v. Brown,
20 Cal. 3d 765, 144 Cal. Rptr. 758,
576 P.2d 473 (1978) 14
Trihedron Int'l Assur., Ltd. v. Superior Court,
218 Cal. App. 3d 934, 267 Cal. Rptr. 418 (1990) . . 16-18
United States v. James Daniel Good Real Property,
__ U.S. __, 114 S.Ct. 492, 126 L.Ed.2d 490 (1993) . . . 20

STATUTES

Page(s)

Federal

15 U.S.C. §§ 1011-1015 17
28 U.S.C. § 1257 . . . . . 2, 9, 10
28 U.S.C. § 2403(b) 2

State

Alabama Code § 27-10-53(a) 21
Alaska Statute § 21.33.031(a) 21
Arkansas Statute Ann. §23-65-205(1) 21
California Code Civ. Proc. § 1033.5(a)(6) 15
California Government Code § 12211 16
California Insurance Code § 699 16
California Insurance Code § 700(a). 3
California Insurance Code § 705.1 16
California Insurance Code § 1610 12
California Insurance Code § 1616 . . . . . 1, 2, 6-8, 10, 11, 15, 18-22, 24
California Insurance Code § 1617 20
California Insurance Code § 1620 . . . . . 6, 12, 21
California Insurance Code § 1763 4
California Insurance Code § 1765 4
California Insurance Code § 1780.50(a) 4
Colorado Rev. Stat. § 10-3-1004(1) 21
Connecticut Gen. Stat. § 38a-27(a) 21
Delaware Code Ann. tit. 18, § 2107(a) 21
Florida Stat. § 626.908(1) 21
Georgia Code Ann. § 33-5-57(a) 21
Hawaii Rev. Stat. § 431:8-208(a) 21
Idaho Code § 41-1208(1) 21
Illinois Rev. Stat. ch. 215, para 5/123(5) 21

Indiana Code § 27-4-4-4(a) 21
Kansas Stat. Ann. § 40-2003(a) 21
Kentucky Rev. Stat. Ann. § 304.11-040(7) 21
Louisiana Rev. Stat. Ann. § 1255(A) 21
Maine Rev. Stat. Ann. tit. 24-A, § 2107(1) 21
Massachusetts Ann. Laws ch. 175, § 168 4
Massachusetts Gen. Laws Ann. ch. 175B, § 3(a) 21
Minnesota Stat. Ann. § 60A.21, Subd. 3(1) 21
Mississippi Code Ann. § 83-21-45 21
Missouri Ann. Stat. § 375.281 21
Montana Code Ann. § 33-1-615 21
Nevada Rev. Stat. § 685B.060(1) 21
New Hampshire Rev. Stat. Ann. § 406-B:6(I) 21
New Jersey Rev. Stat. Ann. § 17:51-2(a) 21
New Mexico Stat. Ann. § 38-1-9(A) 21
New York Ins. Law § 1213(c)(1) 21
North Carolina Gen. Stat. § 58-16-35(c) 21
North Dakota Cent. Code § 26.1-11-15 21
Ohio Rev. Code Ann. § 3901.18(A) 21
Oregon Rev. Stat. § 746.340(1) 21
Rhode Island Gen. Laws § 27-16-1.5(a) 21
South Carolina Code Ann. § 38-25-550(a) 21
South Dakota Codified Laws Ann. § 58-8-13 21
Tennessee Code Ann. § 56-2-607 21
Texas Ins. Code Ann. Art. 1.36, § 11(a) 21
Utah Code Ann. § 31A-15-107(1) 21
Vermont Stat. Ann. tit. 8, §3387 21
Virginia Code Ann. § 38.2-806 21
West Virginia Code § 33-4-13(c)(1) 21
Wyoming Stat. § 26-12-205(a) 21

MISCELLANEOUS

"Mealey's Litigation Reports - Insurance,"
May 2, 1995, at 13-14 21
9 *Moore's Federal Practice,*
¶ 110.13[5], at 153 (1995) 10, 11
Business Insurance,
September 11, 1995 at 12 3
Handbook Of The National Conference
of Commissioner on Uniform State Laws
And Proceedings Of The Forty-Eight Annual
Conference 383 (1938) 24
Proceedings of the National Association
Of Insurance Commissioners 131 (1949) 24

PETITION FOR WRIT OF CERTIORARI

Petitioners, certain Underwriters at Lloyd's, London and London Market insurance companies, designated as "Lowsley-Williams and Companies," respectfully pray that a writ of certiorari issue to review the decision of the California Court of Appeal, First Appellate District, Division Five ("Court of Appeal").

OPINIONS BELOW

The opinions and orders entered below are:

- the San Francisco Superior Court order requiring Petitioners to post a bond under California Insurance Code section 1616 (App. 1a-3a);

- the California Court of Appeal order summarily denying Petitioners' petition for writ of mandate (App. 6a-7a);

- the California Supreme Court order granting Petitioners' petition for review and transferring the case back to the California Court of Appeal (App. 8a-9a);

- the Court of Appeal opinion upholding the constitutionality of California Insurance Code section 1616 (App. 10a-25a);

- the Court of Appeal order denying Petitioners' petition for rehearing (App. 26a-27a); and

- the California Supreme Court order denying Petitioners' petition for review of the Court of Appeal opinion (App. 28a).

JURISDICTION

The Court of Appeal entered its judgment on April 25, 1995, and denied a timely petition for rehearing on May 17, 1995. The California Supreme Court denied a petition for review on July 13, 1995. This Court has jurisdiction to review the judgment by writ of certiorari pursuant to 28 United States Code section 1257(a).

This petition for certiorari draws into question the constitutionality of California Insurance Code section 1616. 28 United States Code section 2403(b) may apply. Petitioners have served the Attorney General of the State of California.

CONSTITUTIONAL PROVISION INVOLVED

The Fourteenth Amendment to the United States Constitution provides in pertinent part: "nor shall any State deprive any person of life, liberty, or property, without due process of law ...."

STATEMENT

This petition arises out of a court order requiring Petitioners to post a bond in excess of $30 million as a pre-condition to defending themselves in a dispute involving insurance policies issued in compliance with state regulatory positions communicated to the insurance industry. The order was made pursuant to California Insurance Code section 1616, which states:

> Before any nonadmitted foreign or alien insurer shall file or cause to be filed any pleading in any action, suit or proceeding instituted against it, the insurer shall either (1) procure a certificate of authority to transact insurance in

> this state;[1/] or (2) give a bond in the action, suit or proceeding in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in the action, suit, or proceeding.

Under the California statute, the trial court required Petitioners to post a bond as a pre-condition to filing their initial responsive pleading, without any preliminary inquiry into the validity of the insured's unverified complaint.

A. The Surplus Line Insurance Market

A brief overview of the insurance market through which the insurance policies at issue were placed is important to understand the factual context of this petition.

For decades, Petitioners have operated as nonadmitted insurers in California and virtually all other states, issuing insurance as part of the "surplus line" market. This surplus line market provides an alternative source of insurance to meet the needs of policyholders that have unusual exposures or that seek large excess liability insurance limits not available through admitted insurers. The California legislature has expressly acknowledged the importance of the $1.3 billion California surplus line market[2/] in helping to fulfill the needs of California insurance purchasers:

[1/] A certificate of authority is issued by the California Insurance Commissioner to an insurer that has been admitted to "transact [a] class of insurance business in [California]." Cal. Ins. Code § 700(a).

[2/] Surplus line insurance premiums nationwide totaled $7.9 billion in 1994. California surplus lines insurance premiums in 1994 were approximately $1.3 billion. *See*, September 11, 1995 Business Insurance, at 12.

> The Legislature finds and declares that consumers in the State of California have insurance needs which cannot always be met through the admitted insurance market. For this reason, many insurance consumers need access to insurance underwritten by nonadmitted insurers, as permitted by law.

Cal. Ins. Code § 1780.50(a).

In order to attract insurance coverage to meet these unique needs, California, like most states, allows surplus line insurers to operate free from direct control, typically regulating surplus line insurance by licensing and regulating surplus line brokers. *See, e.g.*, Cal. Ins. Code §§ 1763 and 1765; Mass. Ann. Laws ch. 175, § 168. The states require these brokers to have surplus line licenses, to assure that the needed insurance is not available through the admitted insurance market, and to protect the policyholders by placing the insurance only with financially sound nonadmitted insurers. *See, e.g.*, Cal. Ins. Code §§ 1763 and 1765; Mass. Ann. Laws ch. 175, § 168.

B. Summary Of Facts

For decades, Petitioners, as nonadmitted insurers, have issued insurance to United States policyholders through licensed surplus line brokers, which are hired by policyholders to procure their insurance and to protect their interests. Before the issuance of the insurance policies involved here, the California Department of Insurance had "communicated to the industry" that an out-of-state licensed surplus line broker that negotiated insurance for an out-of-state policyholder with some insured operations in California was not subject to California surplus line regulatory requirements.

In fact, because the surplus line insurance policy here was such "a multi-state risk negotiated and placed outside of California

under authority of an insurance license issued by the state in which the placement [was] negotiated," the Department of Insurance has confirmed in an *amicus curiae* letter brief in this action that the policy was "not subject to California surplus line reporting requirements." (App. 33a-34a)

In early 1984, Raytheon, a Massachusetts-based corporation, renewed its excess liability insurance policies for its worldwide operations (R 136),[2] which included a site in Mountain View, California. As the Court of Appeal observed, Raytheon's multi-state risk was negotiated and placed outside of California through a Massachusetts-licensed surplus line broker.

> Raytheon, with its principal place of business in Massachusetts, hired an insurance broker, Frank B. Hall & Co. of Massachusetts, Inc. (Hall), to negotiate policy renewals on its behalf. Hall was licensed by the State of Massachusetts as a surplus line insurance broker [footnote].... After determining that the additional excess coverage requested by Raytheon was not available from insurers admitted to transact insurance in the State of Massachusetts, Hall, using a London broker, obtained the additional insurance from [Petitioners]. Raytheon does not dispute [Petitioners'] assertion that the insurance negotiations conducted by Hall occurred either in Massachusetts or in London, and not in California. The trial court found that the Lloyd's policies "were issued outside of the State of California." (App. 12a)

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[2] The notation "R" refers to the pages in the appellate record filed in the proceedings below.

Nine years later, Raytheon filed suit claiming insurance coverage for liabilities arising out of its pollution of the Mountain View site. (R 1) Although Raytheon's insurance policies contain pollution exclusions (R 64 and R 140), Raytheon does not allege any facts to avoid the effect of those exclusions.[4] (R 11-47)

C. Proceedings Below

Shortly after filing its First Amended Complaint, Raytheon made a motion under California Insurance Code section 1616 for an order requiring Petitioners to post a bond in excess of $30 million,[5] or striking Petitioners' answer to Raytheon's complaint should they fail to post a bond. (R 293-94) Petitioners opposed the motion, arguing "that enforcement of any bond requirements under sections 1616-1620 would deprive [Petitioners] of their property without due process of law in violation of the ... Fourteenth Amendment[] of the U.S. Constitution ...." (R 429-30) When Petitioners brought the constitutional issue to the trial court's attention, the trial court referred to an earlier intermediate appellate court decision and stated: "The constitutional issue, I think, was discussed in [the] *Trihedron* case. And we may not have a chance to do anything about that." (R 886)

But the potentially devastating effect of the statute did not escape the trial court, which observed:

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[4] Under California law, the pollution exclusion bars coverage unless the pollution results from a sudden event. *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 15 Cal. Rptr. 2d 815 (1993).

[5] Raytheon's original bond motion seeks a $35 million bond. (R 294) But the declaration of Raytheon's Environmental Manager upon which the bond amount is based alleges $30 million in unreimbursed pollution clean-up costs. (R 325)

> The Court: [Y]ou [Raytheon] come to California with the insurance policy you bought in Massachusetts and then say we got a problem and we're going to sue you [Petitioners] for 30 million dollars and you can't even defend this case unless you put up a bond for 30 million dollars, that is a -- don't you think that just -- there's something wrong there?
>
> [Raytheon's Counsel]: You know, it's an onerous requirement.
>
> The Court: I have to follow the law, there's no question about that, but usually the law makes sense.

(R 902-03) (emphasis added)

The trial court then issued a September 27, 1993 order, ruling that Petitioners "post a bond in an amount to be determined following the deposition of [Raytheon's Environmental Programs Manager] .... This deposition will be limited to the [clean-up] costs outlined in [the Manager's] declaration...." (App. 3a)

On November 23, 1993, Petitioners filed a petition for writ of mandate in the Court of Appeal, contending among other things, that requiring a multi-million dollar bond based only upon allegations in Raytheon's complaint, without any preliminary inquiry into the validity of Raytheon's claims, violated due process as interpreted by this Court for the last quarter-century. On December 1, 1993, the Court of Appeal stayed the trial court proceedings and ordered Raytheon to brief the matter. (App. 4a-5a) On April 29, 1994, the Court of Appeal summarily denied the writ petition and dissolved the stay, finding that Insurance Code section 1616 "does not violate the constitutional right to procedural due process." (App. 7a)

On May 9, 1994, Petitioners filed a petition for review in the California Supreme Court, asserting that application of the pre-answer bond statute was unconstitutional under this Court's controlling decisions holding that property interests may not be deprived without due process of law. On June 16, 1994, the California Supreme Court granted review and transferred the matter to the Court of Appeal, directing it to hear oral argument and to issue a written opinion. (App. 8a-9a)

On April 25, 1995, the Court of Appeal issued an opinion in which it held "that section 1616 does not violate procedural due process of law." (App. 24a) The court found that state regulation of nonadmitted insurers gave rise to exigent circumstances justifying the imposition of the bond without any preliminary inquiry into the validity of Raytheon's insurance coverage claims. (App. 21a-23a) The court also found that although a Massachusetts-licensed surplus line broker had obtained the insurance issued "'outside of ... California'" (App. 12a), no California-licensed surplus line broker had been involved and, as a result, the court found that Petitioners "ha[d] not accounted themselves to the California Insurance Commissioner" (App. 21a).

On May 10, 1995, Petitioners filed a petition for rehearing in the Court of Appeal. In support of the petition, the California Department of Insurance submitted an *amicus curiae* letter brief confirming that it had "communicated to the industry" that transactions such as the underlying transaction conformed to the requirements of California law. (App. 33a-34a) But on May 17, 1995, the Court of Appeal denied the application of the Department of Insurance to file its *amicus curiae* letter brief and denied the petition for rehearing. (App. 26a-27a)

On June 5, 1995, Petitioners filed a petition for review in the California Supreme Court seeking review of the Court of Appeal decision on the ground that the application and operation

of the pre-answer bond statute denied Petitioners their due process rights guaranteed under the Fourteenth Amendment. Surplus line insurers and insurance industry associations from across the country submitted *amicus curiae* letters urging the California Supreme Court to grant review. (App. 36a-100a) On July 13, 1995, the California Supreme Court denied the petition for review. (App. 28a)

D. Why This Is A Final Judgment

1. The Bond Order Is Both Final And Collateral To The Underlying Dispute.

A collateral issue is one involving the "final disposition of a claimed right which is not an ingredient of the cause of action and does not require consideration with it." *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546-47 (1949) (permitting federal appeal of an order denying a cost bond). This Court may consider as "final" for purposes of review those matters involving "claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen*, 337 U.S. at 546; *see also, National Socialist Party v. Village of Skokie*, 432 U.S. 43, 44 (1977) (applying the *Cohen* collateral order doctrine to a petition for certiorari of a state court judgment under 28 U.S.C. § 1257). Under the "*Cohen* doctrine," an order requiring the posting of a pre-answer bond is deemed final. *See, Chabot v. Nat'l Securities and Research Corp.*, 290 F.2d 657, 659 (2nd Cir. 1961) (Second Circuit criticizing as incorrect its own earlier unreported decision that an order requiring an insurer to post security under New York's pre-answer bond statute was not appealable under the *Cohen* doctrine);

9 *Moore's Federal Practice*, ¶ 110.13[5], at 153 (1995) ("the courts have applied the *Cohen* rule to orders that require security").

The issue before this Court involves Petitioners' right to a preliminary hearing on the validity of Raytheon's unverified claims before ordering Petitioners to post a multi-million dollar bond as a pre-condition to defending in a California court. Like the District Court order at issue in *Cohen, supra*, the trial court order imposing a bond under section 1616 does "not make any step toward final disposition of the merits of the case...." *Cohen*, 337 U.S. at 546. Similarly, the pre-answer bond order "will not be merged in final judgment." *Id.* This Court has jurisdiction to consider Petitioners' claim to due process protection because it stands apart from the underlying dispute.

2. The Order Is No Less Final Because The Bond Amount Has Not Been Set.

This Court also has jurisdiction over those cases "in which the federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings." *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 480 (1975) (applying 28 U.S.C. § 1257).

In *Brown Shoe Co. v. United States*, this Court held as final for purposes of appeal under a federal statute, a district court decree requiring appellant shoe company to divest itself of stock and assets held in another shoe company, but requiring appellant to propose a plan for carrying into effect the Court's order. 370 U.S. 294, 308 (1962). This Court observed that "[t]he details of the divestiture which the District Court will approve cannot affect the outcome of the basic litigation in this case ...." *Id.* at 308 n.15.

Likewise, in *Cox, supra*, this Court found that finality could be established where "additional proceedings would not require the decision of other federal questions that might require review by the Court at a later date, [footnote] and immediate rather than delayed review would be the best way to avoid 'the mischief of economic waste and of delayed justice' ...." *Cox, supra*, 402 U.S. at 477-78 (citation omitted). The issue now presented to this Court has these qualities.

Similar to the divestiture plan at issue in *Brown Shoe, supra,* the ministerial function of setting the bond amount will neither eliminate the federal constitutional question, nor give rise to any additional constitutional questions. Irrespective of the precise bond amount, the constitutional question will remain as to whether Insurance Code section 1616 should have provided for a preliminary hearing on the validity of the insured's claims before ordering a bond. *See*, 9 *Moore's Federal Practice*, ¶ 110.13[5], at 153-54 (1995) (the *Cohen* doctrine has been limited in application to cases raising a question of law regarding rights associated with the posting of a bond, but not where the only issue pertains to the amount of the bond). Postponing review of section 1616's constitutionality would also create "economic waste and delayed justice" by requiring discovery and briefing on the amount of a bond before determining whether such a bond is constitutionally permissible.

The issue of whether Petitioners were denied due process by the order requiring a bond will be neither eliminated nor expanded by any subsequent amount hearing. Therefore, this Court has jurisdiction to review the issues presented.

REASONS FOR GRANTING THE WRIT

This Court should grant the writ because the requirement of the court below that Petitioners post a bond in excess of $30 million as a pre-condition to defending a lawsuit based upon insurance policies issued in conformance with official "communicat[ions] to the [insurance] industry," with no inquiry into the reasonable possibility of the suit's success, is directly at odds with procedural due process jurisprudence developed by this Court over the past quarter century, including the landmark decision in *Bell v. Burson*, 402 U.S. 535 (1971).

This Court also should grant the writ because this case has nationwide significance.[6/] The California pre-answer bond statute at issue has similar counterparts in over 40 states. And the recent decisions by the California Court of Appeal below and the Texas Supreme Court[7/] upholding the application of these statutes to lawful insurance transactions, coupled with the increasing use of the pre-answer bond motion in high-stakes pollution coverage

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[6/] The "personal jurisdiction" aspect of the statutory scheme containing the bond statute (Cal. Ins. Code §§ 1610-1620) already has been recognized by this Court as "rais[ing] important questions, not only to California but to other States which have similar laws ...." *McGee v. International Life Ins. Co.*, 355 U.S. 220, 221 (1957). But the "notice and hearing" aspect was not before the Court in *McGee*, as the Court observed: "respondent was given a reasonable time to appear and defend on the merits after being notified of the suit." *McGee*, 355 U.S. at 224 (emphasis added).

[7/] *Mid-American Indemnity Ins. Co. v. King*, 38 Tex. Sup. Ct. J. 1018, 1995 WL 407388 (Tex. 1995), application for mandamus filed (July 21, 1995) (not released for publication in the permanent law).

litigation,[9] threatens the continued viability of the $8 billion surplus line insurance industry.

I. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT CONCERNING STATE CREATION, AND SUBSEQUENT DEPRIVATION, OF PROPERTY INTERESTS.

A. State-Created Property Interests In Placing Surplus Line Insurance

Property interests take many forms,[10] arising not from the Constitution, but out of "existing rules or understandings that stem from an independent source such as state law -- rules or understandings that secure certain benefits and that support claims of entitlement to those benefits." *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972) (emphasis added); *see also*, *Perry v. Sindermann*, 408 U.S. 593, 601-02 (1972). Although a unilateral expectation on the part of the person seeking the protection of procedural due process will not give rise to a protected interest, state authorized or approved conduct will. *Roth*, 408 U.S. at 577; *see also*, *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 538 (1985).

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[9] *Leslie Walpole Procter v. Lockheed Corp.*, Case No. 731752, Santa Clara County Superior Court, California ($475 million bond motion filed Feb. 16, 1995); *Exxon Corp. v. Certain Underwriters at Lloyd's of London*, No. 93-040252, 189th District Court of Harris County, Texas ($850 million bond motion filed July 11, 1995).

[10] The term "interest" encompasses the terms: "entitlement," "right" and "privilege." *See*, *Bell v. Burson*, 402 U.S. 535, 539 (1971) ("relevant constitutional restraints limit state power to terminate an entitlement whether ... denominated a 'right' or a 'privilege'").

The California Department of Insurance approved of the manner in which Petitioners issued insurance policies, having "communicated to the industry" that "a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated" is not subject to California surplus line requirements -- and thus is wholly lawful under California law. (App. 33a-34a) In other words, the State of California -- acting through its Department of Insurance -- and the surplus line insurance industry had a pre-existing, mutual understanding that California did not require that a California-licensed surplus line broker be involved in a multi-state risk insurance policy negotiated and issued out of state.[10/]

These mutual understandings between California and the surplus line insurance industry created for Petitioners a property interest (or implied license) to issue the policies involved here without having to become admitted California insurers. The State did not require Petitioners to post a bond or any other security at the time this "license" was granted. And with this "license" came

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[10/] The court below failed to recognize this state-created property interest despite acknowledging that Raytheon procured the policies at issue "'outside of the State of California'" and through a Massachusetts-licensed broker (App. 12a), concluding instead that the issuance of the underlying insurance policies was an "'illegal'" transaction under California law (App. 24a). But this "illegality" conclusion was unsupported by any other court opinion, any Department of Insurance opinion or circular, any Attorney General's opinion, or any enforcement action, and conflicted directly with the position of the California Department of Insurance -- which is charged with the regulation and enforcement of California insurance law (App. 30a), and whose statutory interpretations should receive great deference by the courts. *See, State of South Dakota v. Brown*, 20 Cal. 3d 765, 777, 144 Cal. Rptr. 758, 576 P.2d 473 (1978) ("'the contemporaneous administrative construction of the enactment by those charged with its enforcement and interpretation is entitled to great weight, and courts generally will not depart from such construction unless it is clearly erroneous or unauthorized.' (*City of Los Angeles v. Rancho Homes, Inc.* (1953) 40 Cal. 2d 764, 770-771 [256 P. 2d 305].)").

the inherent right to defend against lawsuits involving these insurance policies.

B. Deprivation Of Property Interests

Section 1616 ignores Petitioners' "license" to issue multi-state risk insurance by conditioning their fundamental right to defend on one of two options: (1) post a bond; or (2) become admitted. Not only are these "options" themselves deprivations of significant property interests, but the manner in which they are applied -- after the "license" has already been granted -- contravenes this Court's decision in *Bell v. Burson*, 402 U.S. 535 (1971).

Petitioners have property interests in any money or collateral required to post a bond.[11] *See*, *Roth, supra*, 408 U.S. at 571-72 ("property interests protected by procedural due process extend well beyond actual ownership of real estate, chattels, or money [footnote]").

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[11] It is true that collateral used in securing a bond may be returned and that premiums spent in procuring a bond may be recovered as costs. But the Due Process Clause protects against even temporary deprivations of property -- and certainly protects against a one- to two-year deprivation necessary to proceed to a trial in this action. A one- to two-year deprivation of collateral for this and other, larger pre-answer bonds could bankrupt Petitioners. This Court has held that "'[t]he Fourteenth Amendment draws no bright lines around three-day, 10-day or 50-day deprivations of property. Any significant taking of property by the State is within the purview of the Due Process Clause.'" *Connecticut v. Doehr*, 501 U.S. 1, 15 (1991) (quoting *Fuentes v. Shevin*, 407 U.S. 67, 86 (1972)). Furthermore, interest on the bond premiums is not a recoverable cost. *See*, Cal. Code Civ. Proc. § 1033.5(a)(6). The premium on a $30 million bond is approximately $300,000 per annum. *See*, *Beaudreau v. Superior Court*, 14 Cal. 3d 448, 456 n.11, 121 Cal. Rptr. 585, 535 P.2d 713 (1975) (the premium on a bond is approximately one percent of the principal amount per annum). At a 10% interest rate, procuring a $30 million bond would result in lost interest (not recoverable as costs) to Petitioners of $30,000 a year.

As for becoming admitted, the underwriting syndicates at Lloyd's, London are statutorily prohibited from becoming admitted in California because they are unincorporated insurers. Cal. Ins. Code § 699 ("a certificate of authority shall not be issued to an unincorporated insurer"). Their only "option", other than forfeiting their right to defend and suffering a default judgment, is to post a bond.

Although the London Market insurance companies are not statutorily prohibited from becoming admitted, the admission requirements involve deprivations of property interests that one California court viewed as being even more onerous than posting a bond.[12/] *Trihedron Int'l Assur., Ltd. v. Superior Court*, 218 Cal. App. 3d 934, 947, 267 Cal. Rptr. 418, 426 (1990). Such conditioning of the continued use of a "license" was held unconstitutional by this Court in *Bell v. Burson*, 402 U.S. 535 (1971).

In *Bell*, this Court addressed the constitutionality of a Georgia statute that required uninsured motorists involved in automobile accidents to post security for the amount of damages claimed by an aggrieved party (in that case only $5,000) or to have their driver's licenses and vehicle registrations suspended. Recognizing that the issuance of a driver's license created a significant property interest, this Court observed:

[12/] Each of 17 London Market insurance companies involved in this case would need to pay a $1770 filing fee to apply for a certificate of authority (Ins. Code § 705.1), and a $350 fee to become qualified to do business in California (Gov. Code § 12211). In total, nonrefundable fees for London Market companies would exceed $35,000, all of which would have to be incurred in order to defend claims against policies issued more than 11 years ago. The companies also would have to comport with additional regulatory requirements.

> If the statute barred the issuance of licenses to all motorists who did not carry liability insurance or who did not post security, the statute would not, under our cases, violate the Fourteenth Amendment. It does not follow, however, that the amendment also permits the Georgia statutory scheme where not all motorists, but rather only motorists involved in accidents, are required to post security under penalty of loss of the licenses.

402 U.S. at 539 (citations omitted).

As with the issuance of driver's licenses in *Bell v. Burson, supra*, the State's police power to regulate insurance might allow the State to ban all surplus line insurance placements covering California risks, or require that insurers provide a bond at the time the policies are issued to the insured.[12/] But having bestowed upon Petitioners a "license" to issue surplus line insurance and defend against claims arising out of those legally-placed policies, this Court's holding in *Bell v. Burson, supra,* bars any state effort to impose additional requirements beyond those required at the time the policies were issued -- absent procedural due process. *Cf., Trihedron Internat'l Insurance, Ltd. v. Superior Court*, 218 Cal. App. 3d 934, 947-48, 267 Cal. Rptr. 418, 426 (1990)

[12/] Under the McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015), although Congress granted to the states the power to regulate the business of insurance free of Commerce Clause restrictions, "Congress, of course, does not have the final say as to what constitutes due process under the Fourteenth Amendment." *State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451, 457 (1962) (holding that the state may not tax insurance transactions taking place entirely outside the state merely because a risk is located inside the state). State regulation of insurance remains subject to fundamental principles of fairness provided by procedural due process.

(distinguishing state-granted licenses from illegal insurance transactions).[14/]

II. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT REQUIRING AN OPPORTUNITY TO BE HEARD.

A person with a "protected interest" may not be deprived of this interest without notice and some meaningful opportunity to be heard. *Fuentes v. Shevin*, 407 U.S. 67, 80 (1972). In *Bell v. Burson, supra*, this Court focused on the fact that liability, "in the sense of an ultimate judicial determination of responsibility [for an automobile accident], play[ed] a crucial role in the [statutory scheme at issue]." 402 U.S. at 541. Observing that the administrative hearing provided prior to the driver's license suspension failed to provide any opportunity to be heard on the issue of liability, this Court found that the Georgia statutory scheme violated the Due Process Clause. 402 U.S. at 541-42.

Like the statutory scheme at issue in *Bell*, liability plays a crucial role in the California pre-answer bond statute. *See,* Cal. Ins. Code § 1616 (the bond is set based upon the potential amount of a final judgment in favor of the claimant). Yet section 1616 does not provide for any preliminary inquiry into the validity of plaintiff's complaint or the defenses to the complaint. A multi-

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[14/] The court below, relying primarily on *Trihedron* in its decision, criticized the manner in which Petitioners addressed *Trihedron*. Yet Petitioners have always maintained *Trihedron's* inapplicability to this case. (*See, e.g.*, R 424, 436, 600, 601, 606, 886, 891-893, 895, 896, 898, 911) *Trihedron* involved an illegal insurance transaction in which the insurer had no state-granted property interest in transacting insurance. *See, Trihedron*, 218 Cal. App. 3d at 948, 267 Cal. Rptr. at 426.

million dollar bond can be -- and has been -- ordered based upon the mere filing of an unverified complaint.[15/]

"The hearing required by the Due Process Clause must be 'meaningful' and 'appropriate to the nature of the case.' It is a proposition which hardly seems to need explication that a hearing which excludes consideration of an element essential to the decision whether licenses of the nature here involved shall be [deprived] does not meet this standard." *Bell, supra*, 402 U.S. at 541-42 (citations omitted). Having bestowed upon Petitioners a "license" to issue surplus line insurance and defend against claims arising out of those policies, the Fourteenth Amendment mandates that the State provide Petitioners with some inquiry into whether there is even a reasonable possibility that Raytheon's claims might succeed, before conditioning Petitioners' inherent right to defend. Surely the right to drive is a right deserving of no greater protection than the right to defend.

III. THE DECISION BELOW IS INCONSISTENT WITH GOVERNING DECISIONS OF THIS COURT CONCERNING EXIGENT CIRCUMSTANCES.

In upholding the constitutionality of section 1616, the Court of Appeal found that state regulation of foreign insurers involved exigent circumstances which warranted a complete denial of any due process hearing (either "pre" or "post" deprivation) to test the validity of the underlying dispute. The court below was wrong. No exigent circumstances exist. And in any event, Petitioners would have been entitled to a prompt post-deprivation hearing.

15/ As the trial court below observed: "Here we have a case [where Petitioners] don't even get to defend a lawsuit before -- we don't even know if the lawsuit has any merit or close to it, you know." (R 904)

A statute may deprive a person of a property interest without a prior hearing only in extraordinary ("exigent") circumstances, which this Court has described as (1) being "directly necessary to secure an important governmental interest or general public interest," (2) involving "a special need for very prompt action," and (3) where "the State has kept strict control over ... the summary seizure of property." *Fuentes v. Shevin*, 407 U.S. 67, 90-91 (1972); *see also*, *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 678 (1974).

The pre-answer bond statute fails to satisfy even one of these requirements, let alone all three. First, "[i]n cases where there is no reasonable possibility of a judgment being rendered against [an insurer], [California's] interest in [ordering a bond] is not, within the context of the State's fault oriented scheme, a justification for denying the process due ...." *Bell, supra*, 402 U.S. at 540. Second, the inherent time lapse between a bond motion, a bond order, and posting the bond, defeats any notion of a need for immediate action on behalf of Raytheon. *See, e.g.*, Cal. Ins. Code § 1617 (the court may postpone compliance with a bond order). Finally, the fact that an insured can invoke the bond requirement merely by filing a claim, without any judicial or administrative inquiry into the claim's validity, dispels any notion of governmental control over the deprivation. *Cf.*, *Calero-Toledo, supra*, 416 U.S. at 679.

Even in those limited situations where exigent circumstances -- not present here -- justify a summary seizure of property, such a finding does not eliminate the requirement for some meaningful hearing, but merely allows the hearing to be delayed to a time promptly after the deprivation. *See, United States v. James Daniel Good Real Property*, __ U.S. __, 114 S.Ct. 492, 501, 126 L.Ed.2d 490 (1993). Section 1616, however, fails to require any inquiry into the reasonable possibility of a suit's

success, either before the bond order or promptly after the bond order.

IV. THE DECISION BELOW POSES A THREAT TO THE EIGHT BILLION DOLLAR SURPLUS LINE INSURANCE INDUSTRY.

The procedural due process infirmities of pre-answer bond statutes are not limited to California's section 1616. Similar statutory schemes exist in 40 other states.[16/] Should these other states' courts elect to adopt the interpretation of the court below regarding the application of the bond statutes to lawful insurance transactions, the continued viability of the surplus line insurance industry is placed at risk.[17/]

[16/] *See*, Ala. Code § 27-10-53(a); Alaska Stat. § 21.33.031(a); Ark. Stat. Ann. §23-65-205(1); Cal. Ins. Code §§1616 and 1620(b); Colo. Rev. Stat. § 10-3-1004(1); Conn. Gen. Stat. § 38a-27(a); Del. Code Ann. tit. 18, § 2107(a); Fla. Stat. § 626.908(1); Ga. Code Ann. § 33-5-57(a); Haw. Rev. Stat. § 431:8-208(a); Idaho Code § 41-1208(1); Ill. Rev. Stat. ch. 215, para 5/123(5); Ind. Code § 27-4-4-4(a); Kan. Stat. Ann. § 40-2003(a); Ky. Rev. Stat. Ann. § 304.11-040(7); La. Rev. Stat. Ann. § 1255(A); Me. Rev. Stat. Ann. tit. 24-A, § 2107(1); Mass. Gen. Laws Ann. ch. 175B, § 3(a); Minn. Stat. Ann. § 60A.21, Subd. 3(1); Miss. Code Ann. § 83-21-45; Mo. Ann. Stat. § 375.281; Mont. Code Ann. § 33-1-615; Nev. Rev. Stat. § 685B.060(1); N.H. Rev. Stat. Ann. § 406-B:6(I); N.J. Rev. Stat. Ann. § 17:51-2(a); N.M. Stat. Ann. § 38-1-9(A); N.Y. Ins. Law § 1213(c)(1); N.C. Gen. Stat. § 58-16-35(c); N.D. Cent. Code § 26.1-11-15; Ohio Rev. Code Ann. § 3901.18(A); Or. Rev. Stat. § 746.340(1); R.I. Gen. Laws § 27-16-1.5(a); S.C. Code Ann. § 38-25-550(a); S.D. Codified Laws Ann. § 58-8-13; Tenn. Code Ann. § 56-2-607; Tex. Ins. Code Ann. Art. 1.36, § 11(a); Utah Code Ann. § 31A-15-107(1); Vt. Stat. Ann. tit. 8, §3387; Va. Code Ann. § 38.2-806; W. Va. Code § 33-4-13(c)(1); and Wyo. Stat. § 26-12-205(a).

[17/] In its *amicus curiae* letter brief, the California Department of Insurance warned that the opinion "could cause significant confusion in the industry should the decision become disseminated." (App. 34a) The decision has been disseminated and has received widespread attention among policyholder counsel and the surplus line industry. *See*, "Mealey's Litigation Reports - Insurance" May 2, 1995 edition excerpt, at 13-14. The opinion already has been cited both within California and outside California: *Tosco Corp. v.*

The surplus line insurance industry was quick to recognize this threat, voicing its concern over the Court of Appeal opinion in *amicus curiae* letters submitted to the California Supreme Court, which pointed out the potentially devastating impact of the opinion:

> The Court's opinion erroneously labels as "illegal" thousands of surplus line insurance transactions that have been condoned by various state insurance departments for decades, including the California Insurance Department and the decision will have devastating financial consequences for surplus lines insurers, thereby making such insurance less available and frustrating the unsatisfied public need for insurance.

June 16, 1995 *Amicus* Letter on behalf of The National Association of Independent Insurers. (App. 37a)

> The potential effects of the statutory interpretation of Section 1616 of the California Insurance Code (hereinafter "Section 1616"), at issue in this case, are nothing short of disastrous to the non-admitted market.

Hartford Accident & Indemnity Co., et al., San Francisco County Superior Court No. 952681, May 30, 1995 Reply Memorandum filed on behalf of Tosco Corporation; *Potlatch Corp. v. The American Ins. Co., et al.*, San Francisco County Superior Court No. 970158, August 28, 1995 Motion to Compel Certain Underwriters to Post Bond Pursuant to Insurance Code § 1616; and *Exxon Corp. v. Certain Underwriters at Lloyd's of London, et al.*, No. 93-040252, 189th District Court of Harris County, Texas (pre-answer bond request for $850 million damages claim).

June 23, 1995 *Amicus* Letter on behalf of The Illinois Insurance Exchange. (App. 46a)[18]

Requiring payments of enormous bond premiums, or imposing restrictions on capital surplus as the result of a surety companies' collateral requirements, would essentially require a forfeiture of insurance premiums and "freeze" an insurer's assets. An order requiring a $30 million bond would result in payment of a bond premium of at least one percent per annum of the principal amount of the bond -- or $300,000 per annum. *See*, *Beaudreau v. Superior Court*, 14 Cal. 3d 448, 456 n.11, 121 Cal. Rptr. 585 535 P.2d 713 (1975). These annual bond premiums would approximate the entire insurance premiums charged for the liability insurance under which Raytheon makes its claims. (R 59, R 82)

The insurance industry functions by pooling risks so that insurers can charge premiums that are but a fraction of the policy limits provided. Pre-answer bond statutes distort the commercial bargain by allowing the insured to demand the entire policy limit as security for a claim, with no regard as to the validity of the claim. A system based upon statistical probabilities and risk-spreading cannot function long when the fundamental premise upon which it is based -- the probability of a covered event actually occurring -- is shifted to the probability of a claim -- meritorious or unmeritorious -- being filed.

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[18] Other prominent members of the insurance industry expressing the same view include: The National Association of Professional Surplus Lines Offices, Ltd., United National Insurance Company, Scottsdale Insurance Company, Evanston Insurance Company, Essex Insurance Company, Institute of London Underwriters, Prometheus Funding Corp. (formerly known as Frank B. Hall & Co.), American International Specialty Lines Insurance Company, American Insurance Association, and The Surplus Line Association of California. *See*, App. 50a-100a.

APPENDIX R

THE SURPLUS LINE ASSOCIATION
OF CALIFORNIA

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July 12, 1995

The Honorable Malcolm M. Lucas
Chief Justice,
and Associate Justices,
California Supreme Court
303 Second St South Tower
San Francisco, California 94107

Re: Lowsley-Williams and Companies v. Superior Court of San Francisco (Raytheon, Real Party in Interest), Supreme Court Case No. SO39735

To the Honorable Chief Justice and Associate Justices:

On behalf of our more than 400 licensed California surplus line broker members, The Surplus Line Association of California

("SLA") respectfully urges you to grant review of the captioned Court of Appeal decision (the "Decision"). The Decision raises issues of statewide impact that seriously affect the ability of large corporate insurance buyers to obtain insurance for property or operations located in multiple states through alternative market mechanisms such as the surplus lines market. The Decision also calls into question the propriety of requiring significant bonds from out of state insurers before defending themselves in California when those insurers conduct transactions entirely out of state and which cover, only incidentally, California risks.

The SLA is a private, nonprofit unincorporated association comprised of all licensed surplus line brokers in California. The SLA was established in 1938. The SLA is now formally designated by the Insurance Commissioner as the state's "surplus line advisory organization" under Insurance Code §§ 1780.50 et seq. (Added by Stats. 1993, c. 1007, § 1, pp. 4603-4610.) As such, the SLA's role is to "facilitate the state's ability to monitor and regulate the transfer of risk on a sound basis through surplus line brokers to nonadmitted insurers in accordance with Chapter 6 [California's surplus line laws] (commencing with Section 1760) and [to] perform certain functions in this state's system of monitoring and regulating the persons and entities involved in this state in the surplus line segment of the insurance industry." Insurance Code § 1780.50.

By virtue of this role and history, the SLA is uniquely qualified to address issues of surplus line insurance and the alternative insurance mechanisms by which insurance is obtained from nonadmitted insurers.

The Decision involves the pre-answer bond requirement of Insurance Code sections 1610-1620 (the "Act") which requires nonadmitted insurers -- here certain Underwriters at Lloyd's and

certain London Market insurance companies -- to post an extraordinarily large pre-answer bond (approximately $30 million) before they may defend themselves in California.

In other similar cases (e.g., Procter & Co. v. Lockheed Corp; Lockheed Corp. v. Aetna et al., Santa Clara Sup. Ct. No. 731752), different plaintiffs are seeking to impose even larger bonds (over $400 million in one case; over $200 million in another) against reputable, financially sound nonadmitted insurers on the California Insurance Commissioner's approved list. We understand that there are many other pre-answer bond cases waiting in the wings.

The Decision fails to take into account commercial realities, improperly analyzes the legal framework governing multistate insurance transactions, and most importantly, misinterprets the Act.

The commercial reality is that, in California today, bonds of the size contemplated in the above cases are unobtainable. If they can be purchased at all, the cost is prohibitive. The Act was promulgated in 1949 during a by-gone era when million dollar litigation was a rare event. Even as recently as the 1980's, California's entire surplus line insurance market premium volume was approximately the same size as a single bond sought in the Lockheed case, supra.

The Decision misinterprets the Act. The Decision states incorrectly that when a company headquartered outside of California, such as Raytheon, negotiates and obtains, outside of California, a policy with a nonadmitted carrier, California surplus lines requirements must be followed in full if the policy includes coverage for any risk located in California. Such logic misinterprets the Act and fails to account for the underscored language:

> "The purpose of this act is to subject certain insurers to the jurisdiction of courts in this State .... The Legislature declares that it is a subject of concern that nonadmitted insurers have issued polices of insurance to residents of this State physically present herein at the time of such issuance, thus presenting to such residents the often insuperable obstacle of resorting to distant forums for the purpose of asserting legal rights under such policies; that this State has an interest in providing to its residents a convenient forum . . . ." (Decision, at 4-5; emphasis supplied.)

This language makes it clear that the Act applies only when an insured is "physically present" in the state at the time the insurance is issued. The Court of Appeal ignored this fundamental provision of the law, but it is one of clear practical import to large, corporate insurance buyers. Such buyers typically insure their property and operations located nationwide or globally from one or just a few locations. These purchasers seek economies of scale and administrative efficiency when they buy through the multi-billion dollar alternative insurance market. Estimates of the size of this alternative market for U.S. purchasers run as high as $22 billion in premium per year. (Tillinghast, Alternative Market Worldwide Volume: CICR's Estimates, Captive Insurance Company Reports (June 1993) pp. 1-3.)

The Decision misunderstands the legal framework for such multistate insurance transactions. Such insurance buyers do not purchase under the surplus line laws of every state in which their insured property or operations are located. In the state where the insurance is transacted -- here Massachusetts -- a surplus line broker may be required; however, the other states in which

covered risks are located, but where the transaction does not take place, do not require a separate surplus line broker licensed in each of those other states. Such a requirement would unduly burden the ability of insurance purchasers with multistate risks to access nonadmitted surplus line insurers.

This legal framework is recognized by the California Department of Insurance (the "Department"). In an amicus curiae letter to the Court of Appeal in the present case, the Department acknowledged that no California licensed surplus line broker was required for Raytheon legally to purchase of insurance covering risks located in California from the nonadmitted insurers through a Massachusetts licensed surplus line broker. As the Department's letter states:

> "It is the position of the Department of Insurance, communicated to the industry, that a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements. The Department does not believe the multi-state risk placement involved in this case, which was negotiated in Massachusetts by a Delaware corporation (with its principal place of business in Massachusetts) and a Massachusetts-licensed surplus line broker, to be illegal under California law." (Amicus curiae letter dated May 10, 1995 to the Honorable J. Clinton Peterson, Presiding Justice and the Associate Justices of the Court of Appeal from Richard F. Finn, Supervising Deputy Attorney General on behalf of the California Department of Insurance in the present action.)

Nor has the California Legislature subjected such insurance buyers to a requirement of using a California surplus line broker for every purchase covering property or operations in California if the purchase is wholly transacted in another state. See Ins. Code § 1760.[28/] Moreover, to impose such a requirement would undermine a legitimate method of purchasing insurance approved by the United States Supreme Court as long ago as 1897 in Allgeyer v. State of Louisiana (1897) 165 U.S. 578 [17 S.Ct. 427] and more recently in Todd Shipyards (1962) 370 U.S. 451 [82 S.Ct. 1380].

The Court of Appeal's erroneous conclusion that it is illegal for insurance buyers to obtain coverage for property and operations in multiple states without using a separate surplus line broker in each state has sent an enormous tremor through this industry.

Additionally, the effect of the Decision goes far beyond simply ensuring that California residents have a convenient forum and enforceable judgments. It will promote forum shopping by litigious multistate businesses who will leap at California's pre-answer bond gambit. Also, it will unfairly prevent reputable insurers from defending suits in California on the merits, even though those insurers have lawfully provided the insurance, have submitted to the personal jurisdiction of California's courts, and in many cases, have also posted financial security in the United States for any judgments against California policyholders. See § 1765.1(b), supra.

[28/] "Any person may negotiate and effect insurance to protect himself, herself, or itself against loss, damage, or liability with any nonadmitted insurer." Ins. Code § 1760(a).

For the foregoing reasons, the SLA requests that this Court grant review.

Respectfully submitted,

/s/

Edgar S. Clark
Executive Director,
The Surplus Line Association of California

APPENDIX S

RULE 29.6 LIST OF PARENT AND SUBSIDIARY COMPANIES

The parent and subsidiary companies of Allianz V.A.G. Munich (n.k.a. Allianz Versicherungs-AG) are as follows:

Allianz AG Holding
Allianz Group
Allianz Allegemeine Rechtsschutzversicherungs-AG
Assecuranz-Co.mpangnie Mercur AG
Bayerische Versicherungsbank AG
Frankfurter Versicherungs-AG
Globus Versicherungs-AG
Kraft Versicherungs-AG

The parent and subsidiary companies of Cie d'Assurances Maritimes Aeriennes et Terrestres SA (CAMAT) are as follows:

Assitalia (INA Group)
AGF

The parent and subsidiary companies of Ancon, UK are as follows:

Exxon Corporation

The parent and subsidiary companies of Bermuda Fire & Marine Insurance Co. Ltd. are as follows:

BF&M Life Insurance Co. Ltd.
Fortress Insurance Co. Ltd.
Hamilton Reinsurance Co. Ltd.
North Atlantic Insurance Company Ltd.
Woodbourne Insurance Ltd.
Bermuda London Underwriting Agency Ltd.
BF& M Management Ltd.
Scarborough Property Holdings Ltd..

The parent and subsidiary companies of British National Insurance Co. Ltd. (n.k.a. North Atlantic Insurance Co. Ltd.) are as follows:

C.I. Services (Holdings) Ltd.
North Atlantic Insurance Co. of Bermuda Ltd.

The parent and subsidiary companies of Brittany Insurance Ltd. are as follows:

Petrofina, SA
Brittany Holdings Ltd.

The parent and subsidiary companies of CNA Reinsurance of London Ltd. are as follows:

Loews Corp
CNA Financial Corp
CNA Management Co. Ltd.

The parent and subsidiary companies of Compagnie Europeenne D'Assurances Industrielles S.A. (CEAI) are as follows:

Petrofina SA

The parent and subsidiary companies of Dominion Insurance Co. Ltd. are as follows:

Fondiaria SpA

The parent and subsidiary companies of Folksam International Insurance Co. (UK) Ltd.are as follows:

Folksam General Mutual Insurance Society of Sweden
Folksam Holdings (U.K.) Limited
Kansa General International Ins. Co. Ltd.
Samvirke Skadeforsikring AS

The parent and subsidiary companies of Generali Insurance Co. are as follows:

Assicurazioni Generali SpA
La Venezia Assicurazioni
Sta Italiana Assicurazione Danni
Trieste e Venezia Assicurazioni
Aurora Assicurazioni
Navale Assicurazioni
Unione Mediterranea di Sicurta
Alleanza Assicurazioni
Friuli-Venezia Giulia Assicurazioni La Carnica
Adria Vita
Assi Ba Sta di Assicurazioni
Agricoltura Assicurazioni Societa Mutta
Risparmio Assicurazioni
Unione Italiana di Riassicurazione
Fincral Finanziamento al Lavoro
Gefina Partecipazioni Finanziarie e Assicurative
Genagricola
Genimmobil Lotto Tre, Prunus, Europ Assistance Italia
EA Rechtsschutz-Versicherung
Europaische Reiseversicherung
Erste Allgemeine Versicherung
CA Generali Versicherung
Generali Allgemeine Lebensversicherung
Generali Ruckversicherung
Interungall Versicherung
La Concorde
Cie Continentale d' Assurances
L' Equite IARD La Federation Continentale and

Europe Assistance
L'Europeenne de Protection Juridique
La Lutece
Generali Krankenversicherung
Generali Lebensversicherung
Deutscher Lloyd Gruppe
Dialog Versicherung
Dialong Lebensversicherungs-AG Interunfall Allgemeine Versicherung Munchener Lebensversicherung
Europaea-Assurance Protection Juridique
Generali Belgium
De Nederlanden van 1870 Co.
Generali Verzekering
Eerste Hollandsche Cos.
Northern Star Insurance Co.
Europa Insurance Co.
Dog Breeders' Insurance Co.
Caja de Prevision y Socorro
Covodonga de Seguros
Banco Vitalicio de Espana
Standard General Insurance Co. Ltd.
Vanguard Insurance Co. Ltd.
Generali do Brasil
Granadina de Seguros Cos.
Aseguradora General
Generali Hellas Generali Life
Anglo Mexicana de Seguros
Union Suisse
Familia Lebensversicherung
Generali Vida
Generali Budapest Biztosito

Generali Sigorto
Providencia Cia de Seguros de Retiro
Providencia Cia Argentina de Seguros
Federation Insurance Co. of Canada
Banco Vitalicio de Espana
Wiener Allianz Lebensversicherung
La Nacional
Atlas
Business Men's Assurance Co. of America
Generali Worldwide Insurance Co.
Transocean Holding Corp
Participatie Mij Graafschap Holland
Gefina International Ltd.
Gefina International NV
Transocean do Brasil
Sao Marcos Empreendimentos e Participacoes Ltd. a
Albula Verwaltung
Beteligungen
La France IARD
Seguros America Banamex
Wiener Allianz Lebensversicherung
Emporiki Insurance Co.
African Development Insurance
World Marine and General Insurances
Migdal Insurance Co.

The parent and subsidiary companies of Heddington Insurance (UK) Ltd. are as follows:

Texaco, Inc.
Texaco Panama Inc.
Heddington Insurance (CIS) Ltd.
Texaco Risk Management (Europe) Ltd.

The parent and subsidiary companies of Ludgate Insurance Company Ltd. are as follows:

RBQ, Ltd.
Ken Randall Associates, Ltd.

The parent and subsidiary companies of Sovereign Marine & General Insurance Co. Ltd. are as follows:

Willis Corron Group plc
Sovereign Insurance (UK) Limited
Greyfriars Insurance Company Limited
Capacity Resources Insurance Company Ltd.

APPENDIX E

FILED: APRIL 25, 1995

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

LOWSLEY-WILLIAMS AND COMPANIES,
Petitioners,
v.

A063833
San Francisco Superior
Court No. 950755

SUPERIOR COURT OF SAN FRANCISCO
Respondent.

_____/

RAYTHEON COMPANY,
Real Party in Interest.

_____/

Insurance Code[2/] section 1616 provides that any nonadmitted insurer sued in California must post a bond in the litigation, in an amount sufficient to secure payment of any final judgment in favor of the California plaintiff. In this case, we

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[2/] All subsequent statutory references are to the Insurance Code.

uphold the statute against a claim that it violates procedural due process of law.

Petitioners Lowsley-Williams and Companies (hereafter Companies) are certain Lloyd's, London underwriters and London Market insurance companies which issued excess third-party general liability policies to real party in interest, Raytheon Company. Companies are defendants in an action brought by Raytheon, seeking declaratory relief that Raytheon's Lloyd's policies provided coverage for personal injuries and property damage stemming from alleged groundwater contamination at Raytheon's semiconductor plant in Mountain View, California. After Companies appeared in the action, Raytheon filed a motion to require Companies, as insurers not admitted to transact insurance in California, to post a bond under section 1616. Companies responded that the statute did not apply; and if it did, it was unconstitutional for failing to provide for a hearing on the potential merit of Raytheon's action before a bond is imposed. The superior court rejected Companies' arguments and ordered that Companies post a bond in the expected amount of Raytheon's liability, estimated at $30-35 million. Companies seek writ review. We initially denied the petition with a brief statement of reasons. The Supreme Court granted review and retransferred the matter with directions to issue the alternative writ. After supplemental briefing and oral argument we again uphold the statute and deny the petition.

I. PROCEDURAL BACKGROUND AND FACTS[3/]

Raytheon is a Delaware corporation with its principal place of business in Lexington, Massachusetts. It has been qualified to

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[3/] Because of the procedural posture of the case, certain background facts must be taken from the pleadings and the filings in this court. The essential facts are not in dispute except where indicated in this opinion.

do business in California since at least 1944. As of 1992, Raytheon's Mountain View, California, semiconductor facility employed 850 people and had over $90 million in sales.

In early 1984, Raytheon sought to renew its existing primary and excess insurance policies on the Mountain View facility. Raytheon, with its principal place of business in Massachusetts, hired an insurance broker, Frank B. Hall & Co. of Massachusetts, Inc. (Hall), to negotiate policy renewals on its behalf. Hall was licensed by the State of Massachusetts as a surplus line insurance broker.[4/] Hall obtained renewal of Raytheon's primary and first-level excess policies from Continental Casualty Company for the policy period April 1, 1984, to April 1, 1985, with coverage of $10 million. After determining that the additional excess coverage requested by Raytheon was not available from insurers admitted to transact insurance in the State of Massachusetts, Hall, using a London broker, obtained the additional insurance from Companies. Raytheon does not dispute Companies' assertion that the insurance negotiations conducted by Hall occurred either in Massachusetts or in London, and not in California. The trial court found that the Lloyd's policies were "issued outside of the State of California." The policies were specifically obtained, however, for coverage of Raytheon's Mountain View, California, facility and operations.

It is undisputed that Companies are not admitted by the State of California to transact insurance within this state. (§ 700.) It is also undisputed that Hall was a licensed surplus-line broker in

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[4/] Surplus line insurance provides a supplemental market for insureds who require excessive amounts of insurance protection, not available from the market of insurers admitted in the state. Such insurance is typically obtained by surplus line brokers who have a sophisticated understanding of the foreign, i.e., out-of-state, market. (See 4 Matthew Bender, Cal. Insurance Law & Practice (1995) §§ 62.01 & 62.02, pp. 62-3 to 62-4.)

Massachusetts, but not in California.

Because of alleged environmental pollution at the Mountain View facility, Raytheon was sued by various government agencies and private parties. Raytheon estimated its liability at $40 million, $30 million above its primary and first-level excess coverage with Continental Casualty. Raytheon turned to Companies as its excess insurers, but Companies denied coverage. Raytheon then filed the instant complaint seeking a declaration of coverage for the 1984-1985 policy period.

Companies filed a notice of appearance in the action and an answer. Raytheon then moved for an order requiring Companies, as nonadmitted insurers, to post a litigation bond pursuant to section 1616. The trial court granted the motion and imposed a bond in an amount to be set after a further hearing on the amount of Raytheon's estimated liability.[3/]

Companies sought relief from the bond requirement by filing a petition for writ of mandate. We stayed the bond order and obtained opposition from Raytheon. We denied the petition with a statement of reasons, rejecting Companies' contention that the bond statute did not apply to the insurance transaction in this case. Relying on a recent decision of the Court of Appeal, we also rejected Companies' contention that section 1616 violated procedural due process for failing to provide for a hearing on the potential merit of Raytheon's lawsuit. (See *Trihedron Internat. Assurance, Ltd. v. Superior Court* (1990) 218 Cal.App.3d 934 *(Trihedron).)*

[3/] The contamination alleged in the suit against Raytheon spans several years. The coverage Raytheon seeks from Companies is limited to one year. Presumably the actual amount of the bond would be set at an appropriate fraction of the total estimated liability of $30 million over the Continental Casualty coverage.

Companies petitioned the Supreme Court for review. Their petition was limited to the procedural due process issue. The Supreme Court granted review and retransferred the matter with directions to issue the alternative writ, but with no specific instructions, designation of issues, or citations to authority. Having issued the alternative writ, ordered supplemental briefing on the due process arguments raised in the Supreme Court, and heard oral argument, we again deny the petition.

II. DISCUSSION

A. The Applicable Law

The bond provision of section 1616 arose from a legislative action to protect California residents, and corporations doing business in California, from malfeasance of nonadmitted insurers. To be an "admitted" insurer, i.e., one "entitled to transact insurance business in this State" (§ 24), an insurer must obtain a certificate of authority from the California Insurance Commissioner. A certificate only issues when a number of prerequisites, including sufficient capitalization, are met. (§ 700 et seq.) It is undisputed that Companies are "nonadmitted" to transact insurance in this state because they have failed to obtain a certificate. (§ 25.)

As nonadmitted insurers, Companies are subject to the Unauthorized Insurers Process Act, codified as section 1610 et seq. (hereafter the Act). In uncodified, aspirational language which was part of the Act but does not appear in the Insurance Code proper, the Legislature declared: "The purpose of this act is to subject certain insurers to the jurisdiction of courts in this State in suits by or on behalf of insured or beneficiaries under insurance contracts. The Legislature declares that it is a subject of concern that nonadmitted insurers have issued policies of insurance to residents of this State physically present herein at the time of such

issuance, thus presenting to such residents the often insuperable obstacle of resorting to distant forums for the purpose of asserting legal rights under such polices; that this State has an interest in providing to its residents a convenient forum for the purpose of asserting and enforcing legal rights under such policies; that if such residents are left to seek remedy in distant forums they will be, for practical purposes, without remedy. In furtherance of such state interest, the Legislature herein provides a method of substituted service of process upon such insurers and declares that in so doing it exercises its power to protect its residents and to define, for the purpose of this statute, what constitutes doing business in this State... (Stats. 1949, ch. 495, § 1, pp. 851-852.)

The Act's codified provisions provide various protections against nonadmitted insurers, not just to residents of this state but to corporations authorized to do business here. Section 1610 provides that certain acts of a nonadmitted insurer, including issuing a policy "to residents of, or to corporations authorized to do business in, this State," amounts to appointing the Insurance Commissioner as attorney for service of process. Section 1611 specifically defines these acts to include, as relevant here, "(1) The issuance or delivery to residents of, or to corporations authorized to do business in, this State of contracts of insurance insuring ... property or operations located in this State."

Section 1616 provides as follows: "Before any nonadmitted ... insurer shall file or cause to be filed any pleading in any action, suit or proceeding instituted against it, the insurer shall either (1) procure a certificate of authority to transact insurance in this state; or (2) give a bond in the action, suit or proceeding in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in the action, suit or pleading."

Early judicial interpretations of the Act made its purpose clear. "The purpose of the California Insurance Code Sections [1610-1620] is to protect insured residents of California or insured corporations authorized to do business in California." *(Canadian Indemnity Co. v. State Automobile Ins. Ass'n* (N.D.Cal. 1954) 126 F.Supp. 819, 821-822. fn. omitted *(Canadian).)* In 1967, our Supreme Court noted that the Act was passed to further state regulation of nonadmitted insurers in the aftermath of the McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015), which provided that the business of insurance could be regulated by the several states. *(People v. United National Life Ins. Co.* (1967) 66 Cal.2d 577, 583, 597-598.) In this vein, the Supreme Court also noted "'the business of insurance is affected with a public interest' [citation] and . . . there is a duty upon the Insurance Commissioner of this state 'to protect the rights of all insurance policyholders.'" (*Id.* at p. 595.)

B. The Nonissues of This Case

Apart from the constitutional challenge to the statute, Companies raised several issues before the trial court and before this court at the initial stages of this writ proceeding. Both the trial court and this court rejected those issues. Companies failed to seek review of these issues in the Supreme Court in their petition for review. Accordingly, we determine that Companies have waived their right to seek further review of these issues, and we interpret the Supreme Court's transfer order as limiting our attention to the sole issue raised in the petition for review: whether section 1616 violates procedural due process.[4]

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[4] California Rules of Court, rule 28 (e)(2) provides, in pertinent part, that a petition for review "shall state the issues presented for review"; such statement shall be "short and concise"; and "[o]nly the issues set forth in the petition and answer or fairly included in them need be considered by the court." The

We do, however, briefly note the nonissues for purposes of clarity and so the parties understand what issues we regard as already settled.

1. Residence

Companies argued below that section 1616 does not apply to this case because it was only intended to protect California *residents,* and not foreign corporations doing business in California. The trial court found that there was no residency requirement on the face of the statute. That conclusion was correct, and we upheld it in our initial writ review. As we noted in our previous denial order, section 1616 "was intended to protect not only residents of California but corporations . . . doing business in this state." (See *Canadian, supra,* 126 F.Supp. at pp. 821-822.)

2. "California Insurance Transaction"

Companies also argued below that section 1616 does not apply because the issuance of the insurance policies by London

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Advisory Committee Comment to this rule states that "The statement of issues is, therefore, far more than a means of persuading the Supreme Court to grant review: *the statement also defines the scope of the issues to be considered on the merits if review is granted, unless the Supreme Court determines otherwise.* The committee expects the Supreme Court to follow the practice of the United States Supreme Court under its rule 21.1, and decline (in most cases) to consider the merits of questions that were not set out in the petition for review or answer." (Fifth par., italics added.)

The petition for review in this case formally raised two issues: the first is the procedural due process issue and the second is essentially a restatement thereof, and is not separately argued in the petition for review. While the answer discussed the other several issues which were raised below and in this court initially but were excluded from the petition for review, the answer did not raise them as issues for the Supreme Court to decide, but as reasons for denying review. The reply to the answer did not dispute this characterization.

Thus, the Supreme Court having failed to specifically instruct us to the contrary, we consider our review limited to the constitutional due process issue raised by the petition for review.

insurers to Raytheon in Massachusetts, through a Massachusetts surplus line broker, was not a "California insurance transaction." The trial court rejected this contention, noting that section 1611 specifically defined transacting insurance in California to include the "issuance or delivery to... corporations authorized to do business in[] this State of contracts of insurance insuring... property or operations located in this State." The trial court also relied on section 35, which broadly defines transacting insurance to include the "(d) Transaction of matters subsequent to execution of the [insurance] contract and arising out of it." The trial court concluded: "It is undisputed that Raytheon is authorized to do business in California and that the underlying insurance polices insured property and operations located in this State. The policies insure activities in California and arise out of occurrences in California. The policies relate to a 'California insurance transaction' for purposes of section 1616."

We upheld this conclusion on our initial review. We note that the policies in question were specifically intended to cover a major California corporate facility and its operations; that Raytheon's complaint alleges agents of Companies investigated Raytheon's claims in California; that Companies' answer affirmatively alleges Raytheon acted within California to impair investigation of those claims;[2/] that Companies have not objected to the jurisdiction of the California courts; and that at numerous times in the proceedings below and in this court, Companies have argued the applicability of California substantive insurance law to the Raytheon lawsuit.

[2/] It has been suggested that the adjustment of claims within this state constitutes transacting insurance. (*Illinois Commercial Men's Assn. v. State Bd. of Equalization* (1983) 34 Cal.3d 839, 849; see 4 Matthew Bender, Cal. Insurance Law & Practice, *op cit. supra*, § 62.02[3], p. 62-7.)

3. Unwarranted "Extraterritorial" Jurisdiction

On the premise that this case does not involve a California insurance transaction, Companies argue that applying section 1616 to an insurance transaction in Massachusetts is an unwarranted extension of California jurisdiction. We rejected this contention on initial review. Companies' reliance on *State Bd. Ins. v. Todd Shipyards* (1962) 370 U.S. 451 *(Todd Shipyards)* is misplaced. That case involved one state's power to tax an insurance transaction occurring entirely outside the state, and where the taxing state's only tie to the insurance transaction was the presence of the insured property within the state. The case now before us *does* involve a California insurance transaction, with ample California interests involved.[8/]

4. Surplus Line Exemption to Section 1616

Companies also contend that the bond statute does not apply because of section 1620, the Act's last section, which recites that the Act "(a) ... shall not apply to any action, suit or proceeding against any unauthorized [nonadmitted] insurer arising out of any contract of insurance effected in accordance with Sections 1760.5 and 1763 where such contract contains a provision designating a resident of this state or any firm of which one

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[8/] This issue was not raised below, at least with sufficient particularity; Lloyd's did not cite *Todd Shipyards* to the trial court.

Also not raised below, but examined and rejected on our initial writ review, is Lloyd's curious argument based on *Bell v. Burson* (1971) 402 U.S. 535, whose applicability to the present case we are unable to divine. In *Bell*, the United States Supreme Court simply held that Georgia could not require a motorist involved in an accident to post a bond, without regard to fault, or suffer license suspension. The court premised its ruling on the general principle that a state may not infringe upon a significant property interest without some form of adequate procedural due process. *Bell* has nothing to do with the permissible prejudgment deprivation of property in cases of exigent or unusual circumstances, such as regulation of foreign insurers, which we will discuss *post*.

member is a resident of this state to be its true and lawful attorney upon whom may be served all lawful process in any such action, suit or proceeding."

Section 1763 applies to California-licensed surplus line brokers, and authorizes them to purchase insurance from nonadmitted insurers. It is conceded that Hall was a surplus line broker licensed in Massachusetts, *not* California.[9/] Section 1763 is part of California's surplus line laws, which require a California license for the broker which can only issue if certain requirements are satisfied. The laws require the broker to satisfy California authorities of his or her competence and trustworthiness, to withstand an investigation by the Department of Insurance, to post a bond and maintain a California office, and to be "subject to reporting, recordkeeping, and review requirements aimed at facilitating detection of violations of the restrictions" on the issuance of surplus line insurance. (1 Matthew Bender, Cal. Insurance Law & Practice, *op cit. supra,* § 3.03[3], p. 3-14; see discussion in 4 Matthew Bender, *op cit. supra*, §§ 62.08 & 62.09, pp. 62-23 to 62-26.) The laws also provide for California investigations of brokers suspected of impropriety.[10/] The obvious purpose of these laws is to impose state control over those brokers obtaining insurance for California residents or businesses

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[9/] It is immaterial that Hall is a corporate subsidiary of a parent corporation, and a sibling of another subsidiary which may be licensed California surplus line broker. It is Hall who procured the policies in this case, and Hall did not have a California surplus line license. The factual dispute over whether Hall procured the insurance in compliance with Massachusetts surplus line law is also immaterial.

[10/] "The state also relies on self-policing by the surplus line brokers' professional association. *See* 49 Ops. Cal. Atty. Gen. 55, 57-58 (1967)." (1 Matthew Bender, Cal. Insurance Law & Practice, *op cit. supra*, § 3.03[3], p. 3-14, fn. 20.)

from foreign insurers who themselves have not accounted themselves to the California Insurance Commissioner. Since Companies failed to comply with *California* surplus line laws, they cannot claim exemption from section 1616, and their status under California law is that of nonadmitted insurers.

C. The Issue of This Case

Companies argue that section 1616 violates procedural due process because it requires a prejudgment deprivation of property without a hearing or other determination of the merits of a plaintiff's complaint. Companies rely on a long line of decisions generated *by Sniadach v. Family Finance Corp.* (1969) 395 U.S. 337 *(Sniadach),* all of which involve various forms of prejudgment attachment or other creditors' remedies, or else prejudgment litigation bonds in contexts other than state regulation of foreign insurers. The United States Supreme Court has recently restated the rule of *Sniadach* and its progeny: that prejudgment attachment or other deprivation of property generally violates procedural due process except under exigent circumstances. (*Connecticut v. Doehr* (1991) 501 U.S. 1, 8, 18.)

The *Sniadach-based* due process contentions urged by Companies, however, were considered and rejected in *Trihedron,* which concluded that the bond requirement of section 1616 arose under the exigent circumstance of California's need to regulate foreign, nonadmitted insurers. *Trihedron* noted that "The right to procedural due process guaranteed by the United States and California Constitutions requires that an individual be afforded notice and an opportunity for hearing before he is deprived of a significant property interest. *(Randone v. Appellate Department* (1971) 5 Cal.3d 536, 541....)...A pretrial requirement to post bond normally constitutes a taking of property subject to due process requirements. (See *Brooks v. Small Claims Court* (1973) 8 Cal.3d

661, 667-668....)" (218 Cal.App.3d at p. 946.)

Exceptions to the notice-and-hearing requirement "can only be justified in extraordinary circumstances. [Citation.]" *(Trihedron, supra,* 218 Cal.App.3d at p. 946.) "Due process ... does not prohibit all deprivation of property without notice and hearing. In extraordinary situations in which a governmental interest necessitates such action, summary deprivation of property may pass constitutional muster if a statute is narrowly drawn to further that interest. [Citations.]" (*Id.* at p. 947.)

Trihedron concluded that section 1616 furthered the necessary governmental interest of regulating nonadmitted insurers. The court distinguished the *Sniadach* progeny on the ground that those decisions generally involved prejudgment creditors' remedies. "In the creditors' remedies cases the state has no substantial interest to protect in providing plaintiffs with a prejudgment financial advantage over defendants. Here, where a case arises out of a nonadmitted foreign or alien insurer transacting insurance in California, the state has a valid interest in forcing the insurer to comply with the state's certification requirements thereby protecting California insureds and beneficiaries. Section 1616 in the first instance requires compliance with those certification requirements. The statute provides the insurer with the generally less onerous alternative of posting a bond in lieu of meeting the certification requirements. Under these unique circumstances, the bonding requirement can hardly be viewed as a deprivation of a significant property interest subject to due process requirements." *(Trihedron, supra,* 218 Cal.App.3d at p.

947.)[11]

"California requires an insurer to be certified to transact insurance in the state. (§ 700 [,subd.] (a).) An insurer has no right to transact insurance in this state absent compliance with the certification requirements. Section 1616's requirements therefore do not deprive insurers of any substantial interest or existing right. Rather the section encourages compliance with the already existing statutory mandate. Accordingly, we conclude section 1616 does not violate a nonadmitted foreign or alien insurer's due process rights when the insurer is sued in connection with transacting insurance business in California." *(Trihedron, supra,* 218 Cal.App.3d at p. 948.)

Companies do not argue that *Trihedron* was wrongly decided. Neither do Companies take issue with the principle that state regulation of nonadmitted insurers constitutes an extraordinary circumstance justifying exemption from *Sniadach*. Rather, Companies merely attempt to distinguish *Trihedron* on its facts. The attempt falls short.[12]

Companies argue *Trihedron's* ruling was dependent on "two critical facts": the fact that the issuance of the foreign insurance policies through the mails to California residents was a transaction subject to California regulation, and the fact that under California law the issuance of the policies was "illegal."

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[11] To the extent that some *Sniadach*-progeny cases involve prejudgment litigation bonds, the interest of the plaintiff or of the state in those cases was much less significant than the state's interest in regulating nonadmitted insurance companies. (See, e.g., *Beaudreau v. Superior Court* (1975) 14 Cal.3d 448.)

[12] Companies have failed to address *Trihedron's* analysis of the facial constitutionality of section 1616. We assume that by attempting to distinguish *Trihedron* on its facts Companies argue, in essence, the statute is unconstitutional as applied to the facts of this case.

Companies argue these facts are missing from this case. Companies are wrong. As we have established *ante*, the issuance of the Lloyd's policies was a California insurance transaction subject to state regulation. Furthermore, the issuance of the policies in the present case is just as "illegal" as in *Trihedron*. By "illegal," Companies mean the policies were issued to California insureds by a nonadmitted insurer. That is exactly the case herein. Companies maintain that this case is different because they did not issue the policies directly but through a surplus line broker. Companies are correct that in general a nonadmitted insurer may issue insurance to California insureds without certification *if it does so through a bona fide, California-licensed surplus line broker*. Companies are incorrect when they argue that by using a foreign broker not licensed in California, it may insure California persons or business operations without being admitted. Companies' position would allow such insurance to be issued with *no* regulatory oversight by this state, either by means of the admission process or by the licensing regulations of surplus line brokers.[13/]

We agree with *Trihedron* and hold that section 1616 does not violate procedural due process of law.

D. A Closing Remark

Appellate litigation is an arena for forthright debate, not a parlor game for the demure. When Companies filed their petition seeking extraordinary relief, *Trihedron's* constitutional holding stood as the controlling law. In order to obtain extraordinary

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[13/] Companies complain that a surplus line broker's licensing in any state should be sufficient, lest major national surplus line brokers be required to comply with insurance regulations of each of the 50 states, depending on the location of the insured. Such regulatory Balkanization, however, inconvenient is often a necessary evil of federalism.

relief, the ultimate burden on Companies was to demonstrate how or why that controlling law was either bad law not to be followed or good law not applicable to the facts of this case. In a 47-page points and authorities, Companies' sole attempt to distinguish the controlling law was a single footnote.

Chief Justice Cardozo once opined that "The timorous may stay at home." *(Murphy v. Steeplechase Amusement Co.* (N.Y.Ct.App. 1929) 166 N.E. 173, 174.) So too, the timorous should not be rewarded with a grant of Supreme Court review when they have failed vigorously to address at the proper time the unpleasant reality of adverse law.

III. DISPOSITION

The alternative writ is discharged. The petition for writ of mandate is denied. Real party in interest shall recover its costs.

_____

PETERSON, P.J.

WE CONCUR:

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KING, J.

_____

HANING, J.

Lowsley-Williams and Companies v. Superior Court
(Raytheon Company) A063833

APPENDIX F

FILED: MAY 17, 1995

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

LOWSLEY-WILLIAMS AND COMPANIES,
Petitioners,
v.
SUPERIOR COURT OF SAN FRANCISCO,
Respondent.
_____/
RAYTHEON COMPANY,
Real Party in Interest.
_____/

A063833
San Francisco Superior Court No. 950755

THE COURT:

The request of real party in interest Raytheon Company to publish the opinion filed herein on April 25, 1995, is denied.

The application of the California Department of Insurance to file an amicus curiae letter brief in support of the petition for rehearing of petitioners Lowsley-Williams and Companies is denied.

The petitions for rehearing filed by petitioners and by real party in interest are denied.

The opinion filed April 25, 1995, is hereby modified by deleting footnote 4 on page 3 and renumbering all subsequent footnotes.

This modification does not affect the judgment.

PETERSON, P.J.

PETERSON, P.J.

APPENDIX G

FILED: JULY 13, 1995

First Appellate District, Division Five, No. A063833
S039735

IN THE SUPREME COURT OF CALIFORNIA

LOWSLEY-WILLIAMS AND COMPANIES Et Al., Petitioners
v.
SAN FRANCISCO SUPERIOR COURT

RAYTHEON COMPANY, Real Party In Interest

Petition for review DENIED.
Kennard, J. is of the opinion the petition should be granted.

LUCAS

Chief Justice

APPENDIX H

DANIEL E. LUNGREN
Attorney General

State of California
DEPARTMENT OF INSURANCE
50 Fremont Street, Suite 300
San Francisco, CA 94105
(415) 356-6000

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May 10, 1995

Honorable J. Clinton Peterson
Presiding Justice and Associate Justices
California Court of Appeal
First Appellate District, Division Five
Marathon Plaza, South Tower, Suite 600
303 Second Street
San Francisco, CA 94107-1369

RE: *Lowsley-Williams and Companies v. Superior Court (Raytheon Corporation)*
Court of Appeal, First Appellate Dist., Division Five
No. A063833,
San Francisco Superior Court No. 950755
Application of the California Department of Insurance For Leave To File Amicus Curiae Letter Brief In Support Of Petition For Rehearing; Brief

Dear Honorable Justice Peterson and Associate Justices:

The California Department of Insurance requests leave to file an amicus curiae letter brief in this case in support of the petition for rehearing of petitioners Lowsley-Williams and Companies.

The Department of Insurance is familiar with the questions involved in this case and the scope of their presentation and believes that there is a necessity for additional argument on the following point: the legality of the placement of insurance on California property wherein the transaction took place in Massachusetts, with the insured being a Delaware corporation with its principal place of business in Massachusetts, having multi-state operations including the property in California, and the placement being made by a Massachusetts licensed surplus line broker using insurers not admitted in California.

The Department of Insurance believes that its input would be valuable to this Court because it is charged with the enforcement of the California Insurance Code, including regulating surplus line brokers in California (Insurance Code §§ 1760, et seq.). Inasmuch as the Department has been informed that the petitioners will be filing a petition for rehearing, the Department of Insurance hereby seeks permission to file a short letter brief as amicus curiae in the form as attached hereto.

Sincerely,

/s/

RICHARD F. FINN
Supervising Deputy Attorney General

DANIEL E. LUNGREN
Attorney General

State of California
DEPARTMENT OF INSURANCE
50 Fremont Street, Suite 300
San Francisco, CA 94105
(415) 356-6000

FACISMILE: (415) 356-6257
(415) 356-6316

May 10, 1995

Honorable J. Clinton Peterson
Presiding Justice and Associate Justices
California Court of Appeal
First Appellate District, Division Five
Marathon Plaza, South Tower, Suite 600
303 Second Street
San Francisco, CA 94107-1369

RE: *Lowsley-Williams and Companies v. Superior Court (Raytheon Corporation)*
Court of Appeal, First Appellate District, Division Five
No. A063833, San Francisco Superior Court No. 950755
Amicus Curiae Letter Brief In Support Of Petition For Rehearing

Dear Honorable Justice Peterson and Associate Justices:

This letter is respectfully submitted on behalf of the California Department of Insurance.

On April 25, 1995, this Court issued its.decision,in this

matter relating to provisions of the California Insurance Code. The issues concern the placement of insurance on California property owned by Raytheon. Raytheon, a Delaware corporation with its principal place of business in Massachusetts, transacted in Massachusetts with a Massachusetts licensed surplus line broker (not licensed in California) to obtain excess policy coverage on the California property with companies that are not admitted by the State of California to transact insurance within this state. The Court of Appeal decision (on page 12), determined that such insurance was illegal." The California Department of Insurance, as amicus curiae, would like to address only this one point.

The Department of Insurance will specifically address that portion of the Court's decision beginning at page twelve, line nine, the sentence that opens with the word "furthermore":

> "Furthermore, the issuance of the policies in the present case is just as "illegal" as in *Trihedron*. By "illegal," Companies mean the policies were issued to California insureds by a nonadmitted insurer. That is exactly the case herein. Companies maintain that the case is different because they did not issue the policies directly but through a surplus line broker. Companies are correct that in general a nonadmitted insurer may issue insurance to California insureds without certification *if it does so through a bona fide, California licensed surplus line broker*. Companies are incorrect when they argue that by using a foreign broker not licensed in California, it may insure California persons or business operations without being admitted. Companies'

> position would allow such insurance to be issued with no regulatory oversight by this state, either by means of the admission process or by the licensing regulation of surplus line brokers." (This reference also includes footnote 12.)

In agreeing with and applying the law as set forth by the Fourth District Court of Appeal in *Trihedron Intern v. Superior Court* (1990) 218 Cal.App.3d 934, 267 Cal.Rptr. 418, this Court finds that there was a "California insurance transactional, as defined in *Trihedron* and Insurance Code section 1611, and that the "illegal" transaction of insurance has occurred. No citations are given for the conclusion that the transaction of insurance was "illegal" under the particular facts of this case, nor are any citations given for the conclusion that the transaction in this case may only issue "through a bona fide, California surplus line broker."

Amicus curiae Department of insurance submits that the conclusion that the transaction was illegal unless through a California surplus line broker is in error. Insurance Code section 1761 provides in relevant part as follows:

> "Except as provided in sections 1760 and 1760.5, a person within this State shall not transact any insurance on property located ... within ... this State with nonadmitted insurers, except by and through a surplus Ene broker licensed under this chapter and upon the terms and conditions prescribed in this chapter."

It is the position of the Department of Insurance, communicated to the industry, that a multi-state risk negotiated and

placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements. The Department does not believe the multi-state risk placement involved in this case, which was negotiated in Massachusetts by a Delaware corporation (with its principal place of business in Massachusetts) and a Massachusetts-licensed surplus line broker, to be illegal under California law. This position has no conflict with the on decision, which involved no surplus line broker. However, this Court's "illegality" discussion appears to be in conflict with the Department of Insurance's position and could cause significant confusion in the industry should the decision become disseminated. That "illegality" discussion (the first full paragraph, including footnote 12, on page 12 of the slip opinion) is not necessary in reaching this Court's holding that a bond was required under Insurance Code section 1616.

For the foregoing reasons, it is requested that the petition for rehearing be granted or the opinion be modified to delete any reference to the transaction of insurance in this case having been "illegal".

DATED: May 10, 1995.

Respectfully submitted,

DANIEL E. LUNGREN
Attorney General

/s/

RICHARD F. FINN (SBN 56995)
Supervising Deputy Attorney General
Attorneys for Amicus Curiae California Department of Insurance

APPENDIX I

ALISTER McALISTER
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June 16, 1995

Honorable Malcolm M. Lucas, Chief Justice
and The Honorable Associate Justices
California Supreme Court
South Tower, 8th Flr.
303 Second Street
San Francisco, CA 94107-1317

RE: Lowsley-Williams & Companies V. San Francisco Superior Ct. (Raytheon Co. Real Party in Interest), #SO39735, 1st DCA Div 5, A063833, San Francisco #950755

LETTER BRIEF of NAII per
RULE 14(b) in
SUPPORT of the PETITION for REVIEW of
LOWSLEY-WILLIAMS & COMPANIES

Dear Chief Justice Lucas and Associate Justices:

The National Association of Independent Insurers (NAII), respectfully informs this Court of its full support for the petition

for review filed herein by Losley-Williams & Companies, hereinafter called "Companies."

NAII is a trade association of more than 560 property/casualty insurance companies. NAII member companies write about 22% of the total property/casualty premium value in California.

The Court of Appeal's requirement for a nonadmitted insurer to post a bond prior to filing any pleading will deprive surplus line insurers of their constitutional right to defend themselves from unmeritorious claims for coverage, especially since worldwide surety capacity is inadequate to bond all such claims. The Court's opinion erroneously labels as "illegal" thousands of surplus line insurance transactions that have been condoned by various state insurance departments for decades, including the California Insurance Department. And the decision will have devastating financial consequences for surplus lines insurers, thereby making such insurance less available and frustrating the unsatisfied public need for insurance.

I

THE COURT OF APPEALS' OPINION DENIES DUE PROCESS OF LAW TO SURPLUS LINE INSURERS.

The court's opinion results in a deprivation of procedural due process since it requires a prejudgment deprivation of property without a hearing or determination of the merits of the complaint. (Connecticut v. Doehr (1991) 501 U.S. 1, 8, 18; Sniadach v. Family Finance Corp. (1969) 395 U.S. 337.) Under these circumstances, it is mind-boggling to learn of the court's ostensible "exigent circumstances" exception to the normal requirement of

notice and a hearing on the merits before deprivation of property. There are no "exigent circumstances" in this case. Raytheon's invocation of the pre-answer bond statute is simply an attempt to exert settlement pressure in a pollution coverage case precisely because the statute requires the bond regardless of the merits of the claim. Exigent circumstances may only be found where because of some emergency there is imminent danger of irreparable harm or loss. (Manefee & Son v. Department of Food & Agriculture (1988) 199 Cal.App.3d 774, 781-782, 245 Cal.Rptr. 166 (emergency seizure of contaminated food); Ins. Code §§ 1010-13 (summary seizure of insolvent insurer's assets based on showing of irreparable loss if seizure by Insurance Commissioner did not occur immediately, to be followed by Superior Court proceeding instituted by the Commissioner "immediately after such seizure").) There is no evidence that Companies cannot satisfy any likely judgment, or that a judgment is even likely. The requested $30,000,000 bond would require payment of a nonrefundable premium of 1% per year, or $300,000 per year, in addition to restriction of capital surplus as the result of any collateral requirements imposed by surety companies. Just one year's bond premium approximates the amount of the insurance policy premiums. Companies may have a valid coverage defense under the policies' pollution exclusion provisions, yet must pay at least $300,000 as the nonrefundable admission price before Companies will even be allowed to enter the courthouse to present their coverage defenses.

Even in those extreme cases where exigent circumstances may justify summary seizure of property, the required hearing on the merits is not altogether eliminated, but merely required to be held promptly after the taking. (Tyler v. Alameda County (1st Dist. 5-3-95) -- Cal.App.4th --, 1995 WL 255656; Leslie's Pool

Mart, Inc. v. Department of Food & Agriculture (1990) 223 Cal.App.3d 1524, 1532, 273 Cal.Rptr. 373; Menefee & Son v. Department of Food & Agriculture, *supra,* 199 Cal.App.3d at 781-782.) The possibility of an eventual trial on the underlying dispute does not justify or ameliorate the denial of due process. (Leslie's Pool Mart, Inc., v. Department of Food & Agriculture ,*supra*, 223 Cal.App.3d ata 1536, quoting Kash Enterprises, Inc. v. City of Los Angeles (1977) 19 Cal.3d 294, 309, 138 Cal.Rptr. 53 (availability of a collateral judicial remedy cannot sustain a seizure procedure which provides absolutely no pre or post-taking hearing).) Nor can a hearing made available by the trial court in the exercise of its discretion defeat constitutional challenge. As explained by Phillips v. San Luis Obispo County Department of Animal Regulation (1986) 183 Cal.App.3d 372, 380, 228 Cal.Rptr. 101 (quoting Coe v. Armour Fertilizer Works (1915) 237 U.S. 413, 424-425, 35 Sup.Ct.625),

> "A hearing granted as a matter of discretion is no substitute for due process. 'It is not enough that the owners may by chance have notice, or that they may as a matter of favor have a hearing. The law must require notice to them, and give them a right to a hearing and an opportunity to be heard.'"

II

THIS SURPLUS LINE TRANSACTION IS NOT "ILLEGAL."

The court's characterization of this surplus line transaction as "illegal" is flatly, erroneous and deeply disturbing in its implications. The court even refused to allow the Department of

Insurance's *amicus curiae* letter brief on this point in support of Companies to be filed. The Department administers the insurance laws and declared that

> "[T]he conclusion that the transaction was illegal unless through a California surplus line broker is in error ... It is the position of the Department..., communicated to the industry, that a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirement. The Department does not believe the multi-state risk placement involved in this case, which was negotiated in Massachusetts by a Delaware corporation (with its principal place of business in Massachusetts) and a Massachusetts-licensed surplus line broker, to be illegal under California law. This position has no conflict with [Trihedron Internat'l Assurance, Ltd. v. Superior Ct. (1990) 218 Cal.App.3d 934, 267 Cal.Rptr. 418], which involved no surplus line broker. However, this Court's "illegality" discussion appears to be in conflict with the Department of Insurance's position and could cause significant confusion in the industry...."

The court also refused to allow to be filed the *amicus* brief of the Surplus Lines Association of California in support of Companies.

If the opinion is allowed to stand, brokers who place insurance for policyholders with multi-state operations will need to be licensed in each state where the policyholder operates, or obtain the involvement of different brokers licensed in each such state.

Since most large brokers use separate subsidiaries licensed separately in each state so as to avoid conflicting state regulations, and since most states discourage or prohibit informal cooperation among licensed brokers where the individual licensed broker has not had actual involvement in the insurance placement, the court's analysis creates an inescapable but wholly unjustified dilemma for placement of multi-state surplus lines placements.

Companies do not argue that licensing of the broker in *any* state should be sufficient, but rather that licensing in the state in which the insured is located and the insurance is placed (in Raytheon's headquarters state, Massachusetts) should be enough.

III

THE DECISION WILL IMPOSE DEVASTATING FINANCIAL CONSEQUENCES FOR SURPLUS LINES INSURERS AND WILL REDUCE THE AVAILABILITY OF INSURANCE.

Under Part I, *supra* we have already explained the adverse financial consequences to Companies in just this one case. But there are thousands of similar surplus lines insurance transactions. The potential bond premiums could total hundreds of millions of dollars. Furthermore, capital surplus will be restricted as the result of any collateral requirements imposed by surety companies, thereby reducing much needed insurance capacity.

CONCLUSION

The adverse consequences of the Court of Appeal's decision are potentially staggering to the surplus lines insurance

industry and to those many major businesses that rely upon its capacity to furnish a substantial portion of their insurance needs. The decision denies due process of law to surplus lines carriers and unfairly labels as "illegal" many of their perfectly normal, proper and eminently necessary transactions, heretofore considered lawful by the Department of Insurance. The issues in this case therefore raise important issues in connection with the administration of justice and merit authoritative resolution by this Court. Review should be granted both because it is necessary to resolve the conflict between this decision and the longstanding interpretation of the law by the Department of Insurance, and for settlement of important questions of law. (Cal. Rules of Court, rule 29(a).) NAII therefore respectfully requests that this Court grant Companies' petition for review.

Respectfully submitted,

/s/

ALISTER McALISTER (28379)
California Counsel
NATIONAL ASSOCIATION of
INDEPENDENT INSURERS

APPENDIX J

IIE
Illinois Insurance Exchange

June 23, 1995

Chief Justice and Associate Justices of the
Supreme Court of the State of California
SUPREME COURT
Marathon Plaza, South Tower, 8th Floor
303 Second Street
San Francisco, CA 94107

RE: Lowsley-Williams and Companies v. Superior Court (Raytheon Company)
Case No. A063833; S039735

Dear Chief Justice and Associate Justices of the
Supreme Court of the State of California:

The Illinois Insurance Exchange (hereinafter the "IIE") respectfully submits this amicus curiae letter in support of Lowsley-Williams and Companies, the defendants and petitioners in the above-captioned case, requesting that review of their petition be granted.

The issue of requiring non-admitted insurers to post bonds prior to filing any pleadings to defend themselves is one of great importance, not only to the IIE, but to the entire non-admitted insurance industry as well. This Court must address this issue to avoid a potential flood of meritless claims against non-admitted

insurers who provide essential, but otherwise unavailable insurance coverage to California residents and companies doing business in the state.

The IIE is a unique American institution. It was created by an act of the Illinois legislature in 1979[14/] and issued its first policy in 1982. Originally patterned after Lloyd's of London, the IIE is comprised of twelve active underwriting syndicates which have an aggregate policyholders surplus (net worth) of almost $170 million.[15/] As of year-end 1994, the IIE had combined assets of over $600 million.[16/] The IIE is an approved surplus lines insurer in 46 states, and according to Business Insurance, a national insurance trade publication, it is the fifth largest surplus lines market in the country.[17/]

The terms "non-admitted" and "surplus lines" are often used interchangeably. Non-admitted simply means that the insurance company is not licensed in California. "Admitted," on the other hand, means companies which are formally licensed in the state. Certain non-admitted companies are permitted to write surplus lines insurance pursuant to a comprehensive system of regulations promulgated by the California Department of Insurance.[18/]

[14/] 215 ILCS 5/107.01 et seq.

[15/] Illinois Insurance Exchange 1994 Annual Statement (hereinafter "Annual Statement"), p. 2.

[16/] Annual Statement, p. 2.

[17/] Lenckus, "Surplus lines market report," Business Insurance, Sept. 26, 1994, at 3.

[18/] California Code of Regulations, Title 10, Chapter 5, Subchapter 1, Article 4, Section 2174.

The surplus lines insurance industry provides coverage for policyholders which is unavailable from the admitted market often due to the high risk nature of the insurance sought. Surplus lines insurance is obtained through a licensed surplus lines broker who must provide proof that the coverage he is seeking to place with a non-admitted insurer is unavailable from the admitted market. Some examples of surplus lines insurance coverage which the IIE syndicates have provided in California include the following: earthquake coverage, property insurance in the South Central Los Angeles area, coverage for minority contractors, coverage for start up businesses, and coverage for day care and recreational facilities. All of these products are very important to residents of California. At the same time, the California market is crucial to the IIE. Our 1994 Annual Statement reflects that out of over $250 million in direct premiums written, $30.9 million was written in California alone.[19/]

California is very important to other non-admitted insurers as well. According to the California Surplus Lines Association, the amount of filed premium processed through their office, underwritten by non-admitted insurers in California in 1993 was in excess of $1.5 billion. The California Surplus Lines Association was authorized by statute, which became effective January 1, 1994,[20/] "[t]o help ensure that insurance consumers have access to financially sound and reputable non-admitted insurers. . . ."[21/] The stated purpose of the organization is to "facilitate the state's ability to monitor and regulate the transfer of

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19/ Annual Statement, p. 131.

20/ Cal. Ins. Code, Section 1780.50 (1993).

21/ Id. at Section 1780.50(a).

risk on a sound basis through surplus line brokers to non-admitted insurers in accordance with [the statute] and may perform certain functions in this state's system of monitoring and regulating the persons and entities involved in this state in the surplus line segment of the insurance industry."[22/]

The duties the Commissioner of Insurance may delegate to the California Surplus Lines Association include such things as: keeping track of documents which need to be filed with the Commissioner, conducting reviews and analyses of all foreign and alien non-admitted insurers seeking to write business in California, and making recommendations to the Commissioner whether any non-admitted insurer should be added to or deleted from the Commissioner's approved list.

SECTION 1616

The potential effects of the statutory interpretation of Section 1616 of the California Insurance Code (hereinafter "Section 1616"), at issue in this case, are nothing short of disastrous to the non-admitted market. Any non-admitted insurer conducting business in California is a potential blackmail target for plaintiffs without a legitimate case. All the plaintiff needs to do is to make a claim against a non-admitted insurer, and the non-admitted insurer is then forced to make a difficult decision. The insurer must either post a bond in the amount determined by the court before it can begin to defend itself, or the insurer can refuse to post the bond and run the risk that a default judgment will likely be entered against it for violation of Section 1616. Besides the significant financial impact, to allow the Court of Appeal's decision to stand without review would make it much more

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22/ Id. at Section 1780,50(b).

difficult to detect and defend against fraudulent claims to the detriment of the entire California insurance-buying public. Such a significant impact should not be allowed without review by the highest court in the State.

There are statutes similar to Section 1616 in other states throughout the country. Their original purpose was to make sure a non-admitted insurer would be subject to the jurisdiction of that state's local courts. This purpose has already been achieved in California through Regulation 2174 of the California Insurance Regulations which requires surplus lines insurers to appoint a local agent for service of process.[23/] The purpose of Section 1616 was not to provide a club with which to extort settlements from non-admitted insurers unable to post bonds. Regardless of the original purpose behind the statute, the Court of Appeal's interpretation provides a means of blackmailing non-admitted insurers.

Section 1620(a) of the California Insurance Code exempts from the application of Section 1616 any claim arising out of any transaction which was lawfully transacted through a licensed surplus lines broker where the contract designates a California resident as an agent for service of process.[24/] Although the business the IIE syndicates write in California is always placed through licensed surplus lines brokers, neither the IIE nor any other legitimate surplus lines carrier is immune from the effects of this decision of the Court of Appeal as it extends the reach of Section 1616 beyond California's borders.

In the case at bar, the policy out of which the claim arose was written in Massachusetts through a surplus lines broker

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[23/] California Code of Regulations, Title 10, Chapter 5, Subchapter 1, Article 4, Section 2174.5(c).

[24/] Cal. Ins. Code, Section 1620.

licensed in that state.[25] The transaction did not violate any laws of Massachusetts;[26] however, the California Court of Appeal held the transaction was illegal since there was no "bona-fide California-licensed surplus-line broker."[27] The connection which the policy has to California is that one of the properties insured under the policy is located in California.[28] Since the transaction was not placed through a licensed California surplus lines broker, the trial court held, and the Court of Appeal affirmed, that Section 1616 requires Defendants to post a bond before they can begin to defend themselves.[29] The Court of Appeal ignored the position of the California Surplus Lines Association and the California Department of Insurance that no California surplus lines broker was needed and that the Court of Appeal's characterization of the transaction as "illegal" was wrong.

The effect that the Court of Appeal's interpretation of Section 1616 would have on the IIE and other surplus lines carriers cannot be ignored. In this case, the State of California has insisted on requiring a pre-answer bond, simply because a claim has been asserted, prior to any hearing on the merits.[30] Insurers like the IIE syndicates which write business all over the country would be subject to the effects of this decision, no matter how

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[25] California Court of Appeal opinion, p. 2.

[26] Id. at p. 3.

[27] Id. at p. 12.

[28] Id. at p. 3.

[29] Ct. OfAppeal and Superior Ct. Orders are attached to Defendants' Petition for Review.

[30] Defendants' Petition for Review, p. 19.

remote the connection between the policy issued and the State of California may be.

This reading of Section 1616 has the potential to become a money-making weapon for plaintiffs with frivolous or meritless claims while at the same time deterring reputable non-admitted insurers, such as the IIE, from conducting business in California. If the benefits of conducting insurance business in California are outweighed by the possibility of being sued without an opportunity for the insurer to defend itself unless it first posts a bond, non-admitted insurers will either cease doing business in California or will adjust their premium rates to account for this new exposure. Ironically, by deterring non-admitted insurers from conducting business in California and thereby making such hard-to-place coverage even more unavailable, the Court of Appeal effectively harms precisely the group Section 1616 had intended to benefit, California resident policyholders of non-admitted insurers.

CONCLUSION:

For the reasons set forth above and all the reasons raised in the Petition for review, the IIE respectfully requests this Court to grant defendants' Petition and accept this matter for review.

Respectfully Submitted,

ILLINOIS INSURANCE EXCHANGE

/s/

By _____

Gerald F, Murray

V. P. and General Counsel

APPENDIX K

National Association of Professional
Surplus Lines Offices, Ltd.
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Richard M. Bouhan
Executive Director

June 22, 1995

The Honorable Malcolm M. Lucas,
Chief Justice,
and The Honorable Associate Justices
California Supreme Court
Marathon Plaza - South Tower, 8th Floor
303 Second Street
San Francisco, CA 94107

Re: Lowsley - Williams and Companies v. Superior Court (Raytheon Company), 1 Civil No. A063833, S039735

Dear Chief Justice Lucas and Associate Justices of the California Supreme Court:

A petition to review the above captioned case is currently pending before the California Supreme Court.

The National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO), a nationwide organization of surplus lines brokerage firms and companies, urges the court to grant this petition and hear this important case. NAPSLO's membership consists of nearly 500 surplus lines brokerage firms and nearly 100 companies that write insurance on a nonadmitted basis through licensed surplus lines brokers. NAPSLO membership includes 105 member brokerage firms that are California surplus lines licensees and virtually every NAPSLO member company transacts business on a surplus lines basis with these California brokers.

Surplus lines insurance is insurance coverage legally obtained from nonadmitted companies when the coverage cannot be found in the state's licensed market. Surplus lines insurance is primarily commercial property/casualty insurance often covering large industrial/commercial enterprises that have difficult, unique or hard to place insurance risks.

According to a major trade publication, Business Insurance, insurance buyers in the U.S. purchase more than $8 billion of surplus lines insurance annually.[31/] California represents nearly $1.4 billion of this surplus lines premium or 18% to 20%[32/] of the total annual surplus lines volume written in the United States.

The regulation of the surplus lines insurance business is conducted by the various state insurance departments under the authority of the McCarran Ferguson Act[33/], which delegates the

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31/ Business Insurance, September 26, 1994, Page 13

32/ Id. Page 13

33/ 15 U.S.C.A., Secs, 1011-1015, Public Law 15, 79th Congress

regulation of insurance to the states. Each U.S. jurisdiction has enacted a surplus lines law which requires agents and brokers placing surplus lines business with nonadmitted carriers to use a surplus lines licensee, or have a valid surplus lines license, when making the placements. Because surplus lines insurance covers commercial/industrial activities, surplus lines insurance policies often reflect an insured's exposure in a number of different states, Consequently, a California risk may well be insured through a multi-state surplus lines placement legally made by a surplus lines broker licensed and located in a state other than California. Such multi-state surplus lines placements have been considered by the industry, and the regulatory community, as legal placements in all states in which the exposures are insured since they are transacted in compliance with the surplus lines law of the state in which the placing broker is licensed. This view contrasts sharply with the perspective of the Court of Appeal in the captioned case, which opined that this type of transaction was "illegal" and violative of California law.

Such a view of multi-state surplus lines transactions is not only inconsistent with long established legal views held within the industry but also, if upheld, could lead to difficulties in insuring California risks in the future since nonadmitted companies writing this insurance could be forced, by operation of the statutes at issue (Insurance Code sections 1616 and 1620(b)), to post substantial and costly bonds simply to defend themselves in California courts and may not wish to be placed in that position.

Given the commercial/industrial nature and the high limits included in surplus lines insurance coverages, these bonds often could be substantial, reaching a level of many hundreds of millions of dollars. Since worldwide surety bond capacity could easily fall far short of the amount of the bond needed, such bonds, in some

circumstances, could be unavailable to the company. Moreover, the cost of these bonds, if available, could be substantial or prohibitive. Therefore, should a California lawsuit against a nonadmitted insurer having insured a California risk through a legal multi-state surplus lines transaction occurring in another state be based upon a frivolous or unmeritorious claim, the company could be prohibited from defending itself in California courts. This is a particularly unjust result when the company obtained the placement and provided the insurance on the California risk in a legal manner from a licensed surplus lines broker in another state and in compliance with that sister state's laws.

While NAPSLO recognizes that California Insurance Code sections 1616 et. seq. are aimed at preventing or discouraging "rogue" companies from transacting insurance business on an illegal basis, insurance companies accepting business which covers California risks as part of legal placements which comply with the surplus lines laws of other states should not be penalized, and through an egregious pre-answer bond requirement denied due process, simply because the geographical location of the placing broker is outside California. Such companies are not "rogue" companies, but legitimate insurers insuring California risks in compliance with the law.

It is NAPSLO's opinion that should these pre-answer bonds continue to be required in California when the policy in dispute in the legal action is part of a multi-state surplus lines transaction occurring in another state, many surplus lines companies will exclude California risks from the policies they write. This could make coverage for many California risks difficult, if not impossible, to obtain. The cost in terms of "lost" coverage is incalculable, but certainly hundreds of millions of dollars annually.

A determination of the status of the pre-answer bond requirement (California Insurance Code sections 1616 et.seq.) to nonadmitted companies insuring California exposures through multi-state surplus lines transactions will have an enormous impact on future insurance availability for commercial/industrial insurance risks located in California. Therefore, NAPSLO respectfully and strenuously urges the court to grant the petition for review in the above captioned case.

Sincerely yours,

/s/

Richard M. Bouhan
Executive Director and
General Counsel

RMB/mg

APPENDIX L

UNITED NATIONAL GROUP

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Hallmark Insurance Company, Inc.

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June 22, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices of the California Supreme Court
Marathon Plaza - South Tower
8th Floor, 303 Second Street
San Francisco, CA 94107

RE: ***Lowsley-Williams and Companies v. Superior Court,***
1 Civil No. A063833, S039735, captioned in the trial court as
Raytheon Company v. Certain Underwriters at Lloyd's London, et al.

Dear Chief Justice Lucas and Associate Justices of the California Supreme Court:

United National Insurance Company was founded in 1960 and is now in its 35th year of continued growth. The Company (and its subsidiaries) are rated A+ by A.M. Best Company, long regarded as the most reliable rating organization in the insurance industry. The United National Group is authorized to write Surplus Lines insurance in all states of the United States. By last count United National was the fourth largest writer of Surplus Lines insurance.

The decision in the above case is of great concern to the industry known as the Surplus Lines insurance industry. This industry is of considerable importance to the economy and the smooth operation of the insurance industry in the United States. Business done by the industry has reached over $10 billion per year. And, also of considerable importance, is the fact that California is the number one state in the country in volume of Surplus Lines business.

I should like to give you a brief overview of the nature of this business. The standard insurance business in the United States is generally based upon filed rates and forms. Both are subject to the approval of the various state insurance departments, and once the forms and rates have been filed and approved they are rigid guidelines for the insurance business of the filing company.

However, there are many fields that do not conform to this pattern. Some of the non-conforming subjects are obvious. These would include earthquake insurance, hazards created by lead paint, the asbestos hazard, pollution possibilities, and similar high-risk businesses. In addition, there have developed in recent times significant fields that cannot be covered by standard or normal insurance. For example, patent infringement in the high technology fields, animal mortality problems with respect to rare animals, liability arising out of very large entertainment and

sporting events, the modern phenomenon of product recall and, most recently, railroad liability.

Many of these situations would not necessarily have a California connection at the time that the policy is written. For example, many wealthy individuals will purchase personal property floaters covering all risks to their furs, jewelry and other personal property. However, the admitted insurance companies, i.e., Allstate, State Farm, Aetna, Travelers, and the like, cannot accept personal property insurance for an Elizabeth Taylor, Michael Jackson or Madonna. These are target risks and the standard rate filing for these companies is not adequate to cover such risks. Also, in many cases it must be specially tailored to their needs. It is the Surplus Lines market which has the flexibility to rate these risks and write policies of insurance to cover them.

At the time of the coverage there may be no California connection and there would obviously be no need for filing in California. However, for the purpose of illustration, let us assume that a wealthy individual who lives in New York obtains a personal property floater from a Surplus Lines company. The policy has a provision excluding unset (loose) diamonds. The individual moves to California and suffers a major theft loss which includes a bag of unset diamonds. This wealthy individual (like many) has a home in California. Theft was from this home. She makes a claim and the insurance company will not pay for the unset diamonds. She brings a legal action in California. The policy was negotiated in New York and the Surplus Lines broker filed in New York, but the suit in question is in California. Under the above-captioned decision now before the court, technically the insurance carrier could be required to file a pre-answer bond before even being permitted to file an answer to a lawsuit based upon the uncovered claim.

Now let us make a minor change in the hypothetical facts. Assume that the Surplus Lines insurance company wanted to protect itself against precisely this situation. The only possible way it could do so is to employ a California Surplus Lines broker and have him file the appropriate documents in California. However, what is it that he would file? The insured lives in New York state. Ninety-nine percent (99%) of the insured's personal property is kept at the home in New York. It is a practical impossibility for the Surplus Lines company to make a filing in California. More importantly, the industry has never been regulated in a manner which would require such a filing.

In conclusion I would like to point out that the application of the pre-answer bond statutes in most cases, including the case now before the court, does not serve the purpose for which these statutes were initially enacted. We recognize that there are situations, for example, where fly-by-night insurers sell liability insurance in California without admission, appropriate Surplus Lines filings, or otherwise, that would be good cases for pre-answer bonds. But in reality, the fly-by-night insurers in such cases have no problem with the pre-answer bond statutes [Insurance Code Sections 1616 and 1620(b)] because they simply ignore the lawsuits, or ignore orders requiring bonds. However, where the defendant is responsible and respectable (as, for example, Lloyd's of London in the instant case) the pre-answer bond requirement is used simply to harass, resulting in unnecessary legal expense and time, or worse, forcing the settlement of an unmeritorious claim, which in turn encourages others to file questionable claims in hopes of extorting a quick settlement.

We respectfully ask this Court to grant review of the decision of the Court of Appeal and rule that a pre-answer bond cannot be required in the instant case or similar cases.

Respectfully submitted,

/s/

Seth D. Freudberg, President
United National Insurance Group

APPENDIX M

MANATT, PHELPS & PHILLIPS
1501 M Street N.W., Suite 700
Washington, D.C. 20005-1702

June 22, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices
California Supreme Court
Marathon Plaza - South Tower
8th Floor, 303 Second Street
San Francisco, CA 94107

Re: *Lowsley-Williams and Companies v. Superior Court, 1* Civil No. A063833, S039735, captioned in the trial court as *Raytheon Company v. Certain Underwriters at Lloyd's London, et al.*

Dear Chief Justice Lucas and Associate Justices
of the California Supreme Court:

We represent Scottsdale Insurance Company ("Scottsdale"), Evanston Insurance Company ("Evanston"), and Essex Insurance Company ("Essex"), each of which is a surplus line insurer that insures risks in California and numerous other states on a "nonadmitted" or "surplus line" basis. Scottsdale is the second-largest surplus line insurer in the United States, and California is Scottsdale's largest insurance market. California represents one of the larger insurance markets for Evanston and

Essex.

In the above-captioned case (hereinafter, *"Lowsley-Williams"* or the "Opinion"), the Court of Appeal upheld the constitutionality of Section 1616 of the California Insurance Code ("Code"), which requires nonadmitted insurers either to obtain a certificate of authority or to post a bond as a condition of defending litigation instituted against them in California. For the Court's consideration, our clients respectfully suggest that the Court of Appeal's decision in *Lowsley-Williams* erroneously upholds a clearly unconstitutional statute, reflects a fundamental misunderstanding of how the surplus line insurance industry is regulated, and will seriously disrupt the surplus line business in California if not corrected by the Court. Indeed, the decision below is the second Court of Appeal decision to dangerously confuse how the surplus line insurance business is regulated in California and elsewhere. Notwithstanding the rule that prohibits citation of unpublished opinions, the Court of Appeal's decision in this case already is being presented to the lower courts in California and numerous other courts nationwide.

The surplus line insurance market is essential to small businesses, inner-city businesses, and to California's largest and most sophisticated commercial insureds. The Court should grant the petition for review to correct the fundamental regulatory misconceptions of the court below. Equally important, the Court should correct the regulatory disinformation reflected in the lower court's decision that will do considerably more damage to the commercial insurance markets than the supposed lack of "regulatory oversight" the Court of Appeal apparently thought it was required to cure.

The petition for review filed by Lowsley-Williams and Companies (collectively, the "Companies") presents an important

question of law that should be settled by the Court. Accordingly, and for the reasons set forth below, we respectfully urge the Court to grant the petition.

A. Issue for Review

The issue for review is whether Section 1616, which requires nonadmitted insurers either to obtain a certificate of authority or to post a bond as a condition of defending litigation in California, violates the insurers' right to due process because it does not provide for predeprivation notice or hearing on the merits of the plaintiff's complaint.

B. Important Questions of Law to Be Settled

1. Out-of-State Surplus Line Placements Do Not Violate California Law

The Court of Appeal erred in concluding that issuance of a surplus line policy in Massachusetts to a large corporation headquartered in Massachusetts -- covering the insured's operations "throughout the world and in space" -- through a licensed Massachusetts surplus line broker in compliance with Massachusetts law nonetheless violated California's surplus line law. California's surplus line law, however, only applies to a person "within this State" who transacts insurance on property or operations in California with nonadmitted insurers. *See Code* § 1761. Since all of the parties involved in the negotiation, issuance, and delivery of the surplus line placement at issue were acting outside of California, California's surplus line law did not apply, even though the corporate insured had operations in the State at the time of the placement.

In fact, the California Insurance Department, in an *amicus curiae* letter submitted to the court below, expressly agreed that the surplus line placement to Raytheon in Massachusetts was not

illegal under California law.

2. Section 1616 Is Unconstitutional

The Court of Appeal also erred in holding that Section 1616's bonding requirement does not violate due process because the statute offers nonadmitted insurers the alternative of procuring a certificate of authority. Yet the licensing alternative is entirely illusory:

- Whereas Section 1616 prohibits nonadmitted insurers from filing any pleading in a lawsuit arising from a single California insurance transaction, the Department of Insurance does not issue certificates of authority for insurers that do not anticipate ongoing business activity in California -- and certainly not for a single transaction -- and it does not issue certificates retroactively.

- Section 700(e) of the Code contemplates a review period for each license application that can last as long as 180 calendar days, and in practice it not infrequently takes years to obtain a certificate of authority in California. It is difficult to imagine that a trial court would consent to a postponement of the action, pursuant to Section 1617 of the Code, to permit the nonadmitted insurer to complete a lengthy licensing process.

Without a *bona fide* licensing alternative, Section 1616 leaves nonadmitted insurers no choice: to file a pleading in any action instituted against them in California, they must post a bond,

without *any* hearing on the merits of the plaintiff's complaint. Under the governing decisional law of both the United States Supreme Court and the California Supreme Court, such a statute is unconstitutional. *See, e.g., Connecticut v. Doehr,* 501 U.S. 1, 111 S. Ct. 2105 (1991; *Mathews v. Eldridge,* 424 U.S. 319, 96 S. Ct. 893 (1976); *Fuentes v. Shevin,* 407 U.S. 67, 92 S. Ct. 1983 (1972); *Randone v. Appellate Dep't, 5* Cal. 3d 536, 488 P.2d 13, 96 Cal. Rpt. 709 *(1971), cert. denied,* 407 U.S. 924 (1972).

The Court of Appeal's reliance upon the analysis set forth in an earlier decision upholding the constitutionality of Section 1616 was misplaced, and that decision, *Trihedron Int'l Assur. v. Superior Court,* 218 Cal. A.P. 3d 934, 947, 267 Cal. Rpt. 418 (1990), should be overruled.

C. **The Decision Below Will Disrupt Surplus Line Regulation**

The Court of Appeal obviously did not understand the role of surplus line insurers within the insurance regulatory system, and its holding is completely at odds with established insurance regulatory interpretations and practices throughout the country.

The surplus line insurance industry serves as a "secondary market" for property and casualty insurance risks, predominantly commercial risks, that "licensed" or "admitted" insurers are unable or unwilling to insure. Surplus line insurers often are referred to as "nonadmitted" insurers because, by definition, they do not hold licenses or certificates of authority in the jurisdictions where they write business on a surplus line basis.

The surplus line business is regulated in all states primarily through regulation of surplus line brokers, who are specially licensed to "export" to the surplus line "market" the risks that admitted insurers have declined. Surplus line insurers do not have offices or claims facilities, nor do they advertise, in states where

they are not admitted; they operate through licensed surplus line brokers or, in some instances, accept direct placements ("independent procurements") by the insureds themselves.

The Court of Appeal incorrectly assumed that the Companies necessarily must be subject to "regulatory oversight" in California and that failure to issue the policy through a California surplus line broker (or to obtain a certificate of authority) meant that the Companies were seeking to evade California regulatory requirements. *See* Opinion at 12. In fact, at the time the placement at issue was made, neither the California Legislature nor the California Insurance Commissioner had chosen to subject such placements to "regulatory oversight" by California -and the "regulatory oversight" that is now in place *still* does not require surplus line insurers to obtain a certificate of authority. See Code § 1765.1; Cal. Code Regs. tit. 10, § 3275.

Unless reversed by the Supreme Court, the Opinion will disrupt surplus line regulation in California and throughout the United States. Plaintiffs everywhere will repeatedly cite the Opinion for the proposition that perfectly lawful surplus line transactions are violations of the Code and perfectly reputable insurance companies that were in full compliance with all applicable insurance laws at time their policies were issued should be treated as outlaws.

D. Conclusion

For these reasons, the Court should grant the petition for review.

Respectfully submitted,

MANATT, PHELPS & PHILLIPS

/s/

Richard A. Brown SBN #54901

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June 30, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices
California Supreme Court
Marathon Plaza - South Tower
8th Floor, 303 Second Street
San Francisco, CA 94107

Re: *Lowsley-Williams and Companies v. Superior Court,* Case No. A063833,
S039735, captioned the trial court as *Raytheon Company v. Certain Underwriters at Lloyd's London, et al.*

Dear Chief Justice Lucas and Associate Justices
of the California Supreme Court:

I respectfully request the Court's permission to correct an inadvertently erroneous citation in the letter we filed with the Court on June 23, 1995, in support of the petition for review in the above-captioned case, on behalf of our clients, Scottsdale Insurance Company, Evanston Insurance Company, and Essex Insurance Company.

In the last full paragraph on page 4 of the letter, we refer the Court to the "regulatory oversight" of surplus line insurers now in place in California. The final citation at the end of that

paragraph should be to Regulation 2174 promulgated by the California Insurance Commissioner, *i.e.*, Cal. Code Regs. tit. 10, § 2174. The regulation number contained in the letter is a typographical error.

Respectfully submitted,

MANATT, PHELPS & PHILLIPS

/s/

Richard A. Brown SBN# 54901

APPENDIX N

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June 29, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices
California Supreme Court
455 Golden Gate Avenue
San Francisco, California 94102

Re: Lowsley-Williams and Companies v. Superior Court of the State of California, City and County of San Francisco
Raytheon Company, Real Part In Interest
Supreme Court of the State of State of California
Case No.: S039735
First Appellate District, Division Five
Case No. A063833

Dear Chief Justice Lucas and Associate Justices
of the California Supreme Court:

We are United States counsel for the Institute of London Underwriters, an association of approximately seventy (70) London insurance companies, many of whom are substantially engaged in the underwriting of surplus line insurance in the United States, and

in California particularly.

On behalf of the member companies of the Institute of London Underwriters we urge acceptance of the Petition for Review filed by Lowsley-Williams and Companies in Lowsley-Williams and Companies v. Superior Court of the State of California, City and County of San Francisco seeking review of the First Appellate District decision holding that a non-admitted surplus lines insurer is required to post a pre-answer bond pursuant to § 1616 of the California Insurance Code without any hearing on the validity of the policyholder's claim.

The application of California Insurance Code Sec. 1616 by the First Appellate District is not only contrary to the interpretation of the California Insurance Department itself but also conflicts with the customary practice for the placing and handling of surplus and excess lines insurance throughout the fifty states as regulated by their respective insurance departments. Moreover, the application of the section ascribed by the First District creates series issues of fundamental notions of due process and will have significant deleterious effects upon the availability of needed surplus lines insurance within the State of California.

The State of California has, as have most other states in the United States, regulations and statutory enactments mandating the thresholds for a non-admitted alien insurer's eligibility to underwrite surplus lines insurance in the State of California. The provisions of this statute provide the minimum trust fund, as well as capital and surplus thresholds, together with other regulatory safeguards for the protection of us policyholders.

The Courts hold also be mindful that any legitimate concerns can be accommodated through methods referred to in Insurance Code Section 1620 by the designation in the polices of an agent for service of process and maintenance of a United States-

based trust fund. The Court of Appeal's decision, however, holds that even insurers have designated a California resident agent for service of process and that have established United States-based trust funds can nevertheless be required to post a bond.

Raytheon's attempt to use Sec. 1616 as an offensive weapon in forcing a pre-judgment bond, the cost of which, if granted, will consume the entire insurance premium creates an oppressive entrance fee to the courts. The consequence is that a statute, originally designed to protect California citizens from disreputable insurers, is being used as an offensive litigation weapon to coerce an unwarranted settlement. By merely wielding the statute, and without any showing of a likelihood of success on the merits, Raytheon has succeeded in gaining an unfair tactical advantage at tremendous cost to the defendant and at significant risk to California insurance market. The consequence is certain to reduce desired insurance capacity in the state and to make that which remains available markedly more costly to the public, all as the result of a risk domiciled and bound out of the State.

The underlying circumstances of the action are typical of the surplus lines insurance market in the United States and hardly presents any unusual dangers to the public: Raytheon, a large multi-national corporation headquartered in Massachusetts, contracted with the Massachusetts office of Frank B. Hall, a multi-state insurance broker, to obtain insurance coverage for risks in an amount not readily available in the admitted marketplace. Hall explored the surplus lines' market and secured for Raytheon acceptable protection coverages for its extensive operations, including the California facility which gives risk to this controversy, all, as noted by the Court of Appeals, in compliance with Massachusetts regulations.

In the instant matter, Raytheon seeks declaration of the

insurers' obligations under the policy with respect to Raytheon's liability to third parties arising from alleged environmental contamination. In doing so, it seeks a bond commensurate with the total value of the policies at issue, some $30-35 million. The cost to the insurer, at a surety fee of 1% per annum, would amount to at least $300,000 per annum. This effectively causes the insurer to forfeit it's entire premium solely for the right to appear in its own defense.

The decision of this Court will be closely followed as it is certain to have far-reaching consequences both within and without the State of California. The recognition of the availability of the statute as an offensive weapon has already spawned numerous motions for similar bonds in matters across the Sate. In one such instance, the plaintiff insured has sought a bond of $475 million, which if granted would likely result in a minimum annual premium fee of about $4.75 million. It is respectfully submitted that the economic consequences of requiring multi-million dollar bonds, without a hearing on the merits, controverts the fundamental notions of due process, and only rewards oppressive litigation tactics.

The effects of requiring a surplus lines insurer to post security in advance of defending against any claim will cause insurers to avoid doing business within the State to the detriment of the populace and economy of the State at large. The chilling effect upon solid insurers seeking to supply needed insurance to satisfy California's needs, who would be more inclined to simply cease doing business when faced with the prospect of paying a premium to contest a significant claim.

The interpretation of the First District is that much more discouraging because it ignores the declared practice of the California Insurance Department as to how the surplus lines

insurance market is intended to operate particularly with respect to an international risk such as Raytheon, based in Massachusetts, and where the risk is placed in the Massachusetts surplus lines insurance market. In our experience, this is a typical placement in the surplus lines market as to which the California Insurance Department has no objection. Similarly, it is typical of the manner in which the insurance departments of the other states of the United States would treat such a cover. The position of the First District thus runs counter to the approved practice of the insurance commissioners throughout the United States and the handling of, literally, hundreds of millions of surplus lines insurance premium annually that would be affected if the decision is allowed to stand.

In the event that this court determines to grant review of the determination of the First District opinion, we will request permission to submit an amicus curiae brief to further elaborate on these points.

We respectfully request that Court accept the Petition for Review of Lowsley-Williams and Companies.

Respectfully Submitted,

/s/

James W. Carbin

APPENDIX O

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June 30, 1995

The Honorable Chief Justice Malcolm M. Lucas
and The Honorable Associate Justices of the
California Supreme Court
303 Second Street, South Tower
San Francisco, Ca 94107-1317

Re: Lowsley-Williams and Companies v. Superior Court of the State of California, City and County of San Francisco, Raytheon Company, Real Party In Interest, No. SO39735

Dear Chief Justice Lucas and Associate Justices:

Prometheus Funding Corp., formerly known as Frank B. Hall & Co. Inc., an international insurance broker, respectfully requests that this Court exercise its authority under California Rule of Court 28 to grant review of the Court of Appeal opinion in Lowsley-Williams and Companies v. Superior Court of the State of California, City and County of San Francisco, Raytheon Company, Real Parties in Interest, filed on April 25, 1995 -- petition for review pending SO39735.

The petition in Lowsley-Williams is a case of first impression, implicating California's regulatory scheme governing surplus lines insurers. The opinion of the Court of Appeal stretches that regulatory scheme to a surplus lines placement that occurred well outside of California's borders. Raytheon Company -- a Massachusetts-based, Delaware corporation -- purchased its required surplus lines insurance coverage in Massachusetts, through Frank B. Hall & Co. of Massachusetts, a Massachusetts licensed insurance broker. The placement of this coverage complied fully with Massachusetts' statutory scheme governing surplus lines insurance.

Although Raytheon received the precise coverage it had requested and paid, through Hall/Massachusetts, the requisite surplus lines tax in accordance with Massachusetts law, the Court of Appeal here nevertheless has declared the placement of the surplus lines coverage to be in violation of California law and therefore has required the insurers to post a significant pre-answer bond ($30 to $35 million) before they can defend themselves in this coverage litigation initiated by Raytheon. In doing so, the court provided Raytheon with an extraordinary tactical advantage that could dictate the outcome of its coverage claims before the merits are heard. More fundamentally, the court has unsettled the market for surplus lines insurance -- to the profound detriment of insurers, brokers, businesses and consumers in California and elsewhere.

The market for insurance placed through surplus line brokers is a vital one as far as businesses seeking insurance coverage are concerned. See Cal. Ins. Code § 1780.50. The surplus lines market provides insurance for hard to place risks that admitted insurers will not insure and also provides large multi-state and multi-national companies with access to hundreds of millions

of dollars in primary and excess coverage which is not available solely from insurers admitted in California. These insureds get the coverage they need -- economically and efficiently -- from non-admitted insurers in the surplus lines market located by brokers like Frank B. Hall. The economy is achieved by the ability to make a single placement, through one broker, in one state, to cover a company's entire operations wherever conducted. Requiring the brokering of the coverage piecemeal -- i.e., through different licensed brokers in every state where a company does business -- would add materially to the cost of the coverage. Requiring regulatory compliance with the laws of every state where the company does business would likewise add to the cost of the transaction as well. Yet, that is precisely what the Court of Appeal's opinion here compels.

This multi-state approach to placement may also limit the insurance markets available to insureds as surplus lines brokers are not permitted to place coverage with insurers who have not been approved by their state regulators. Thus, a placement completely proper for a Massachusetts broker and insureds may be, in part, improper or impossible in Missouri or California. These economic burdens on the placement will substantially alter the current ease of placement and wide access to surplus line insurance markets. The inevitable results are that an economical and readily available form of insurance becomes much more expensive, unduly complex and, worse still, unavailable.

We recognize that the Court of Appeal's opinion is not published and that this Court does not often grant review in unpublished cases because of their lack of precedential value. But word of the court's holding already has made its way through environmental insurance coverage cases, the brokerage industry, and the surplus lines insurance community. Other companies

besides Raytheon are using the pre-answer bond statutes to exert settlement pressure in pollution coverage: cases, irrespective of the merits of the claims for coverage. Accordingly, resolution of the issues presented by the petition is timely and will lend much needed predictability to other coverage disputes -- involving hundreds of millions of dollars -- that involve surplus lines insurance placed with non-admitted insurers.

The petition highlights the fundamental due process problems engendered by the Court of Appeal's reasoning. As applied by the Court of Appeal, California's pre-answer bond statutes are at odds with the controlling case law providing safeguards for individuals and entities before pre-judgment takings occur. Apart from these constitutional infirmities, however, the real significance of the Court of Appeal's holding is in the everyday litigation of insurance disputes. Unless corrected by a grant of review, all insurers that operate in the surplus lines market will be subject to the risk that they might be required to post a bond for any large claim made by a policyholder with operations in California. Policyholders with multi-state operations will then initiate litigation in California and demand a pre-answer bond. Surplus line insurers will have to pay-up or abandon their valid coverage defenses. Many possibly will decline such California-related exposure, thus leaving California insureds with no market for their insurance needs.

And all of this unfairness and inequity will occur in cases -- like this one -- where the concerns addressed by California's regulatory scheme are not even theoretically implicated and there is no need, much less a justification, for a pre-answer bond. The insurers under attack here are well funded, have made substantial deposits in the United States as conditions of doing business, and can answer for any legitimate coverage claims that are ultimately

proven by companies like Raytheon. These companies should not have the power to penalize their insurers for good faith, and likely well founded, denials of coverage. They should not be able to force their insurers to litigate coverage disputes only on penalty of posting a pre-answer bond where there plainly is no need for such a bond to protect their interests. Rather, this coverage litigation should proceed in its ordinary course, on a level playing field, without providing the insureds with the leverage that flows from such an extraordinary tactical windfall.

The Court of Appeal's decision ultimately rests on a literalconstruction of the words in California's Insurance Code that our Insurance Commissioner maintains is erroneous and unintended. Literalism has its place in statutory construction, but not when it leads to absurd or unfair results. That is manifestly the case here. Under such circumstances, a reasonable and pragmatic construction of the. statute should be adopted that comports with constitutional mandates and serves the statutes regulatory purpose. All of that can be achieved here without forcing these petitioners to post a pre-answer bond and we urge this Court to grant review and say so.

The Court of Appeal's opinion here is unsound under the controlling law and bad public policy. Because this tactic of requesting pre-answer bonds is a recurring one, this Court should intervene and put some much needed balance back into the construction of California's surplus lines regulatory scheme.

Respectfully submitted,

/s/

CROSBY, HEAFEY, ROACH & MAY
PROFESSIONAL CORPORATION

/s/

James C. Martin
Attorneys for Prometheus Funding Corp.

APPENDIX P

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July 5, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices
California Supreme Court
Marathon Plaza - South Tower
8th Floor, 303 Second Street
San Francisco, CA 94107

Re: *Lowsley-Williams and Companies v. Superior Court*, Case No. AO63833, S039735, captioned in the trial court as *Raytheon Company v. Certain Underwriters at Lloyd's London, et al.*

Dear Chief Justice Lucas and Associate Justices
of the California Supreme Court:

We represent American International Specialty Lines Insurance Company ("AISLIC"), a surplus line insurer that provides insurance to commercial and municipal entities in California and numerous other states on a "nonadmitted" or "surplus line" basis. In 1994, AISLIC wrote $159 million of insurance on a nonadmitted basis in California and $714.4 million nationwide. AISLIC is the third-largest surplus line insurer in the

United States, and California is AISLIC's largest market.

AISLIC urges the Court to grant the petition for review in the above-captioned case, for the reasons set forth in our separate letter to the Court dated June 22, 1995, submitted on behalf of Scottsdale Insurance Company, Evanston Insurance Company, and Essex Insurance Company. AISLIC agrees that the decision of the Court of Appeal below (hereinafter, the "Opinion") erroneously upholds the constitutionality of Section 1616 of the California Insurance Code ("Code"), reflects a fundamental misunderstanding of how the surplus line insurance industry is regulated in California and elsewhere, and will seriously disrupt the surplus line business in California if not corrected by the Court. Furthermore, AISLIC believes that review of the Opinion is of general importance because it declares as "illegal" a type of multi-state risk placement that occurs with great frequency and with the full knowledge and consent of state insurance regulators.

In addition, AISLIC respectfully submits the following points for the Court's consideration:

- *The petition should be granted to settle an important question of law.* The Court should grant the petition for review because the constitutionality of a state regulatory provision that affects the national and international markets for commercial insurance necessarily is an important question of law.

- *The Court of Appeal misapplied the test for determining whether a state regulatory provision comports with due process.* Relying upon the analysis set forth in an earlier decision upholding the constitutionality of Section 1616, *Trihedron Int'l Assur. v. Superior Court*, 218 Cal.3d 934,

267 Cal.Rptr. 418 (1990), the Court of Appeal disregarded or trivialized any consideration but the state's interest in regulating nonadmitted insurers:

> "Under these unique circumstances" -- where the state has a valid interest in "forcing" nonadmitted insurers to obtain a certificate of authority in California -- "the bonding requirement can hardly be viewed as a deprivation of a significant property interest subject to due process requirements."

Opinion at 11, *quoting Trihedron*, 218 Cal.App.3d at 947. State regulation of insurance, however, is *subject to* the constitutional requirement of due process, *People v. United Nat'l Life Ins. Co.*, 66 Cal. 2d 577, 584, 427 P.2d 199, 58 Cal.Rptr. 599 (1967) -- non *exempt from* it.

Further, far from "forcing' nonadmitted insurers to obtain a certificate of authority in California in all cases, the California Legislature has expressly declared that nonadmitted insurance plays an important role in California's insurance marketplace:

> The Legislature finds and declares that consumers in the State of California have insurance needs which cannot always be met through the admitted insurance market. For this reason, many insurance consumers need access to insurance

underwritten by nonadmitted insures, as permitted by law.

Code § 1780.50(a). Indeed, recognizing the uniqueness of the nonadmitted insurance market, the Legislature consistently has declined to require nonadmitted insurers to become licensed in California. Instead, the Legislature recently imposed substantial financial disclosure requirements on nonadmitted insurers that wish to insure California risks. *See* Code § 1765.1; *see also* Cal. Code Regs. tit. 10, § 2174. Accordingly, there is no merit whatsoever to the Court of Appeal's rationale that public policy requires a certificate of authority as a condition of insuring California residents and businesses.

The constitutional analysis adopted below is erroneous, and *Trihedron*, the source of that analysis, should be overruled.

- *Payment of bond premium or other collateral, whether permanent or temporary, is a deprivation of property.* Section 1616's bonding requirement is a taking of a nonadmitted insurer's property even though premium paid to obtain the bond may be a recoverable cost, or securities deposited as collateral for the bond may be retrieved, if the insurer prevails at the end of the underlying litigation. A party required to post a bond or provide additional collateral to support a bond is deprived of the use of its property during the pendency of the litigation -- which can

last many years. *See Brooks v. Small Claims Court*, 8 Cal.3d 661, 667, 504 P.2d 1249, 105 Cal.Rptr. 785 (1973).

- ***Section 1618 provides for a jurisdictional hearing only, not a hearing on the merits of the plaintiff's complaint.*** The hearing provided by Section 1618 of the Code is jurisdictional only, to determine whether service on the nonadmitted insurer is proper under the provisions of the Unauthorized Insurers Act. Yet due process requires a hearing on the *merits* of the plaintiff's complaint, not just on the lawfulness of service. Once the jurisdictional finding has been made, however, the bonding requirement of Section 1616 is for all practical purposes automatic, without benefit of a judicial determination that the merits of the plaintiff's complaint warrant a bond in any amount.

For these additional reasons, the Court should grant the petition for review, reverse the decision of the Court of Appeal below, declare Section 1616 unconstitutional, and overrule *Trihedron*.

Respectfully submitted,

MANATT, PHELPS & PHILLIPS

/s/

Richard A. Brown (SBN 54901)

APPENDIX Q

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July 7th, 1995

The Honorable Chief Justice Malcolm M. Lucas
and the Honorable Associate Justices
California Supreme Court
Marathon Plaza - South Tower
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303 Second Street
San Francisco, California 94107

Re: *Lowsley-Williams and Cos. v. Superior Court,*
Nos. A063833, S039735 (Raytheon Company)

Dear Chief Justice Lucas and Associate Justices:

Pursuant to Rule 14(b), California Rules of Court, we respectfully submit this letter on behalf of the American Insurance Association ("AIA") as *amicus curiae* in support of the grant of the petition of Lowsley-Williams and Companies for review of the decision of the court of appeal in the captioned matter. The AIA, an association of United States property and casualty insurers, believes review should be granted because the opinion of the court

of appeal adopts an interpretation of the California Insurance Code that is at odds with the realities of insurance markets in California and the United States and offends constitutional principles of due process. Whether or not published, the opinion threatens to cause confusion in pending and future litigation around the country and, as a result, may seriously impact the domestic marketplace for commercial liability insurance in which the members of the AIA operate.

The AIA, which is headquartered in Washington, D.C., is a national trade organization representing 270 companies writing property and casualty insurance throughout the United States. These companies provide approximately 27 percent of all property and casualty insurance underwritten in the country, a substantial portion of which is in the commercial liability insurance field, and more than 17 percent of that business underwritten in California.

The AIA writes this letter as *amicus curiae* to erase any misapprehension that the court of appeal's interpretation of the Insurance Code would give cheer to domestic insurers, including those admitted in California. The domestic insurance industry stands to gain nothing by the erection of new court-fashioned barriers to participation in the marketplace by nonadmitted insurers; for reasons explained below, buyers and sellers of insurance throughout California and the United States' stand to lose much by the suppression of an important source of competition in the marketplace that the court of appeal's interpretation of section 1616 would precipitate.

The court of appeal decision requires reversal because it is grounded on two fundamental errors. The first is its condemnation as "illegal" of the practice, employed by Raytheon Company, of procuring surplus lines insurance in the London market through a licensed broker in another state for the purpose

of covering business operations nationwide. (Opinion of the Court of Appeal ("Op."), p. 12.) This approach does not take into consideration the fact that most states, if not all, have enacted statutory schemes regulating the placement of nonadmitted business and requiring brokers to ascertain the financial condition of the nonadmitted insurers with whom such business is placed. The general approaches of these statutory schemes are not dissimilar to California's. Given these laws, insureds with risks in multiple jurisdictions should reasonably be able to rely on the assumption that business lawfully placed in one state is lawful and acceptable in another. Any conclusion to the contrary presents unnecessary and punitive burdens on the domestic insurance business. Nonadmitted underwriting is not some form of insurance contraband, as the court of appeal implicitly labels it.

The second error made by the court of appeal is the assumption, unsupported by the record, that California's ostensible need to prevent the issuance of such policies amounts to such "exigent," "extraordinary" or "unusual circumstances" (Op., pp. 8 n.7, 10) that the courts are required to intervene in order to regulate nonadmitted insurance without regard to the procedural requirements of due process. The members of AIA are not aware of the existence of any such circumstances that would justify the erection of regulatory barriers of this kind against the operations of nonadmitted insurers for the protection of insureds, claimants or domestic insurers, particularly since other states also regulate the placement of nonadmitted business. Even if California could articulate a justification for the barrier in the form of a regulatory interest -- and the AIA believes it could not -- a court's imposition of a pre-answer bond without due process in this context is anything but a remedy "'narrowly drawn to further that interest'" (Op., p. 10, quoting, *Trihedron International Assurance, Ltd. v.*

Superior Court, 218 Cal.App. 934, 946 (1990)). The only real interest that could be served by the decision of the court of appeal is the tactical advantage sought by policyholders in litigation of questionable coverage claims against insurers who issued policies to them a decade or more ago.

The court of appeal's conclusion about the placement of certain kinds of nonadmitted business is the understandable, if not excusable, by-product of its own decision to dispense with the requirements of due process. By holding that the Insurance Code required a pre-answer bond from Lowsley-Williams and Companies without first requiring a hearing on the facts and circumstances of the case, the court prevented itself from gathering the facts that could have averted this error. The court of appeal has served up a textbook example of the reason the California and United States Constitutions mandate a hearing before the strong arm of the government is summoned to remedy some theoretical evil. The answer of real party in interest Raytheon Company to the petition of Lowsley-Williams and Companies asserts that "facts concerning the condition and operation of the surplus line insurance market were not developed in the record of this case." (Answer to Petition for Review ("Answer"), p. 22.) But it was the court of appeal's dismissal of all due process protections that leads Raytheon to the contention that the Court "lacks the raw material that would be needed" (*id.*) to construe the statute coherently.[24/]

[24/] Raytheon's claim that statutory construction is not an issue (Answer, pp. 3, 5) is misleading. Whether or not Lowsley-Williams could be said to have "waived" questions of statutory construction is irrelevant because the courts, in considering the constitutionality of a statute, must strive for an interpretation of the statute that is not unconstitutional. *Carlos v. Superior Court*, 35 Cal.3d 131, 147 (1983) ("it is our plain duty to adopt that construction which will save the statute from constitutional infirmity"). Insurance Code section 1616 might pass constitutional muster, for example, if it were interpreted to require pre-answer

Raytheon's assertion that this factual void requires the Supreme Court to look the other way in the face of the due process violation that produced it is afflicted with circularity of Kafka-esque proportions.

The court of appeal could not reasonably have concluded from any facts before it that this was one of those "extraordinary circumstances" in which "[e]xceptions to the notice-and-hearing requirement" can be justified. (Op., p. 10.) There is absolutely no evidence that nonadmitted carriers selling insurance through surplus lines brokers licensed in other states have ever posed a greater threat of insolvency, and resulting inability to pay claims involving California-based operations or risks than do admitted carriers -- which is all that Raytheon purports to be concerned about -- and there is no evidence from the history of the enforcement of the Insurance Code that state regulators ever entertained, much less acted on, such a perception.

Even if the State of California had an interest in protecting its residents from such a risk, section 1616 as interpreted by the court of appeal is entirely ill suited, not "narrowly drawn," to further that interest. It is difficult to understand how the goal endorsed by the court of appeal of "forcing the insurer to comply with the state's certification requirement thereby protecting California insureds and beneficiaries" (Op., p. 11) is served by imposing deterrent or punitive measures a decade, in this case, or many decades, as in some of the other environmental insurance coverage cases in which bond motions are now flooding in, after

---

bonds, if ever, only in cases of manifest illegality -- exemplified by non-broker procured mail-order purchases of personal lines insurance from fly-by-night operators (as in *Trihedron, supra*) -- but not in cases characterized by adherence to the regulatory requirements of a sister state and by compliance with custom and practice consistent throughout the country.

the supposedly "illegal" underwriting occurred.[22/] Whether or not the distinction between admitted and nonadmitted insurers might be appropriate for some regulatory purposes, it does not justify jettisoning all due process requirements where the "illegality" of transactions has no temporal or rational linkage with the present solvency of the insurer and the contracts in question were procured through a surplus lines broker duly licensed by one of California's sister states.

Another flaw in the court of appeal's analysis is its apparent assumption that the Insurance Code draws bright lines between the admitted and nonadmitted insurance markets for purposes of erecting regulatory barriers that affect an insurer's right to defend itself in court. If there was ever a basis for such distinctions, time has obliterated it. The impact of the court of appeal decision cannot be confined to a handful of "alien" insurers. Many U.S. companies also do business through insurance brokers licensed in various states -- but not every state -- and some actually do business in the London market directly. More importantly, as other *amici* have noted, the surplus lines market provides an important safety valve for admitted insurers, by expanding overall capacity in the marketplace and fostering the development of new products. (If the London market had been constrained from participating in United States underwriting by regulatory barriers from the beginning, for instance, it is not clear that the domestic

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[22/] To accept the argument that the legislature ever had such a forward-reaching deterrence program in mind is to attribute to the authors of section 1616 clairvoyant anticipation of the development of retroactive liability under environmental regulatory schemes and the imposition of coverage for that liability under policies many years after their expiration. *See, e.g., Montrose Chemical Corp. v. Admiral Ins. Co.*, ___ Cal.4th ___ (July 3, 1995), Slip op., pp. 35-43. In fact, section 1616 was enacted when insurance policies covered only injury caused by "accident" and not continuous or long-term damage. *Id.* at 25-28.

market would have ever introduced "occurrence"-based policies, which were first offered by London, to replace "accident"-based policies on a wide scale; ironically, the kind of closed market Raytheon now extols, if it had in fact existed, might have deprived Raytheon of the opportunity in the first place to buy liability insurance that might cover losses caused by the allegedly continuous injuries that it caused.) Furthermore, the relatively disadvantageous position into which the court of appeal decision might place certain insurers could cause severe repercussions for domestic insurers, many of whom rely on London to furnish reinsurance or retrocession of a significant proportion of their underwriting capacity.[26/]

Finally, the interpretation adopted by the court of appeal could seriously impair the interests of the State of California in maintaining a smoothly functioning liability insurance system. Because of its comparatively open insurance markets, a substantial percentage of the surplus lines business written nationwide over the years has originated in California, written through California-licensed surplus lines brokers. Other states have laws similar to Insurance Code section 1616, with comparable regulatory and enforcement histories -- until now. Allowed to stand, the court of

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[26/] The court of appeal's decision could force nonadmitted insurers to bear a risk that is out of all proportion to their actual exposure to liability, especially in environmental cases involving multiple years of alleged injury. We expect counsel for policyholders to insist in future cases that a pre-answer bond in the total amount of the judgment sought from all insurers on the risk is the minimum amount "sufficient to secure the payment of any final judgment" (Ins. Code § 1616), even though the nonadmitted insurer in question may have issued policies covering only a comparatively small portion of the total number of years in which damage allegedly took place -- despite the fact that this Court has expressed disapproval of the theory that multiple insurers of a long-term loss are "jointly and severally liable," favoring instead adherence to principles of "[a]llocation of the cost of indemnification" (*Montrose, supra*, Slip op., p. 40 n. 19).

appeal decision would signal a challenge to other jurisdictions to adopt reciprocally harsh interpretations of their insurance statutes. The overall effect on the insurance business in general from such a nationwide carnival of retributive insurance regulation, unconstrained by due process, would benefit no one -- not even the policyholders whose short-term interest now stands to be maximized by turning California's pre-answer bond requirement to their tactical gain in pending litigation.[37]

The pre-answer bond requirement, far from being narrowly drawn, is a bludgeon which, if policyholders were allowed to wield it without regard to due process requirements, could frustrate the interests it must reasonably have been designed to protect. Unless this Court grants review for the purpose of adopting a constitutional interpretation of the Insurance Code, the court of

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[37] In its answer to the petition, Raytheon purports to reassure the Court that leaving the court of appeal decision unpublished will prevent its misuse by litigants and courts because "California judges well know the rules concerning the citation of unpublished opinions," which render them "not precedent and not binding in unrelated cases." Answer, p. 20 n. 12. There is no reason, however, to suppose that the restraint of California judges will blind them, much less judges in federal courts or the courts of other states, to all efforts by counsel for policyholders to use the court of appeal decision to embolden them to adopt a similar interpretation of section 1616, whether or not the opinion qualifies as valid precedent under the doctrine of *stare decisis*. By placing responsibility for controlling the impact of an erroneous, but unpublished, decision on judges enforcing the Rules of Court, counsel for Raytheon implicitly signal their intent to continue to exploit the court of appeal decision in any way and in any forum they can -- short of openly violating the California Rules of Court by citing it in appellate briefs governed by them -- in the interest of Raytheon and their other clients.

appeal decision could cause considerable disruption in California's scheme of insurance regulation, which it purports to protect, and the nationwide insurance market into which it is integrated.

Very truly yours,

/s/

Martin S. Checov (State Bar No. 96901)
of O'MELVENY & MYERS

APPENDIX R

THE SURPLUS LINE ASSOCIATION
OF CALIFORNIA

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July 12, 1995

The Honorable Malcolm M. Lucas
Chief Justice,
and Associate Justices,
California Supreme Court
303 Second St South Tower
San Francisco, California 94107

Re: Lowsley-Williams and Companies v. Superior Court of San Francisco (Raytheon, Real Party in Interest), Supreme Court Case No. SO39735

To the Honorable Chief Justice and Associate Justices:

On behalf of our more than 400 licensed California surplus line broker members, The Surplus Line Association of California

("SLA") respectfully urges you to grant review of the captioned Court of Appeal decision (the "Decision"). The Decision raises issues of statewide impact that seriously affect the ability of large corporate insurance buyers to obtain insurance for property or operations located in multiple states through alternative market mechanisms such as the surplus lines market. The Decision also calls into question the propriety of requiring significant bonds from out of state insurers before defending themselves in California when those insurers conduct transactions entirely out of state and which cover, only incidentally, California risks.

The SLA is a private, nonprofit unincorporated association comprised of all licensed surplus line brokers in California. The SLA was established in 1938. The SLA is now formally designated by the Insurance Commissioner as the state's "surplus line advisory organization" under Insurance Code §§ 1780.50 et seq. (Added by Stats. 1993, c. 1007, § 1, pp. 4603-4610.) As such, the SLA's role is to "facilitate the state's ability to monitor and regulate the transfer of risk on a sound basis through surplus line brokers to nonadmitted insurers in accordance with Chapter 6 [California's surplus line laws] (commencing with Section 1760) and [to] perform certain functions in this state's system of monitoring and regulating the persons and entities involved in this state in the surplus line segment of the insurance industry." Insurance Code § 1780.50.

By virtue of this role and history, the SLA is uniquely qualified to address issues of surplus line insurance and the alternative insurance mechanisms by which insurance is obtained from nonadmitted insurers.

The Decision involves the pre-answer bond requirement of Insurance Code sections 1610-1620 (the "Act") which requires nonadmitted insurers -- here certain Underwriters at Lloyd's and

certain London Market insurance companies -- to post an extraordinarily large pre-answer bond (approximately $30 million) before they may defend themselves in California.

In other similar cases (e.g., Procter & Co. v. Lockheed Corp; Lockheed Corp. v. Aetna et al., Santa Clara Sup. Ct. No. 731752), different plaintiffs are seeking to impose even larger bonds (over $400 million in one case; over $200 million in another) against reputable, financially sound nonadmitted insurers on the California Insurance Commissioner's approved list. We understand that there are many other pre-answer bond cases waiting in the wings.

The Decision fails to take into account commercial realities, improperly analyzes the legal framework governing multistate insurance transactions, and most importantly, misinterprets the Act.

The commercial reality is that, in California today, bonds of the size contemplated in the above cases are unobtainable. If they can be purchased at all, the cost is prohibitive. The Act was promulgated in 1949 during a by-gone era when million dollar litigation was a rare event. Even as recently as the 1980's, California's entire surplus line insurance market premium volume was approximately the same size as a single bond sought in the Lockheed case, supra.

The Decision misinterprets the Act. The Decision states incorrectly that when a company headquartered outside of California, such as Raytheon, negotiates and obtains, outside of California, a policy with a nonadmitted carrier, California surplus lines requirements must be followed in full if the policy includes coverage for any risk located in California. Such logic misinterprets the Act and fails to account for the underscored language:

> "The purpose of this act is to subject certain insurers to the jurisdiction of courts in this State .... The Legislature declares that it is a subject of concern that nonadmitted insurers have issued polices of insurance to residents of this State physically present herein at the time of such issuance, thus presenting to such residents the often insuperable obstacle of resorting to distant forums for the purpose of asserting legal rights under such policies; that this State has an interest in providing to its residents a convenient forum . . . ." (Decision, at 4-5; emphasis supplied.)

This language makes it clear that the Act applies only when an insured is "physically present" in the state at the time the insurance is issued. The Court of Appeal ignored this fundamental provision of the law, but it is one of clear practical import to large, corporate insurance buyers. Such buyers typically insure their property and operations located nationwide or globally from one or just a few locations. These purchasers seek economies of scale and administrative efficiency when they buy through the multi-billion dollar alternative insurance market. Estimates of the size of this alternative market for U.S. purchasers run as high as $22 billion in premium per year. (Tillinghast, Alternative Market Worldwide Volume: CICR's Estimates, Captive Insurance Company Reports (June 1993) pp. 1-3.)

The Decision misunderstands the legal framework for such multistate insurance transactions. Such insurance buyers do not purchase under the surplus line laws of every state in which their insured property or operations are located. In the state where the insurance is transacted -- here Massachusetts -- a surplus line broker may be required; however, the other states in which

covered risks are located, but where the transaction does not take place, do not require a separate surplus line broker licensed in each of those other states. Such a requirement would unduly burden the ability of insurance purchasers with multistate risks to access nonadmitted surplus line insurers.

This legal framework is recognized by the California Department of Insurance (the "Department"). In an amicus curiae letter to the Court of Appeal in the present case, the Department acknowledged that no California licensed surplus line broker was required for Raytheon legally to purchase of insurance covering risks located in California from the nonadmitted insurers through a Massachusetts licensed surplus line broker. As the Department's letter states:

> "It is the position of the Department of Insurance, communicated to the industry, that a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements. The Department does not believe the multi-state risk placement involved in this case, which was negotiated in Massachusetts by a Delaware corporation (with its principal place of business in Massachusetts) and a Massachusetts-licensed surplus line broker, to be illegal under California law." (Amicus curiae letter dated May 10, 1995 to the Honorable J. Clinton Peterson, Presiding Justice and the Associate Justices of the Court of Appeal from Richard F. Finn, Supervising Deputy Attorney General on behalf of the California Department of Insurance in the present action.)

Nor has the California Legislature subjected such insurance buyers to a requirement of using a California surplus line broker for every purchase covering property or operations in California if the purchase is wholly transacted in another state. See Ins. Code § 1760.[2/] Moreover, to impose such a requirement would undermine a legitimate method of purchasing insurance approved by the United States Supreme Court as long ago as 1897 in Allgeyer v. State of Louisiana (1897) 165 U.S. 578 [17 S.Ct. 427] and more recently in Todd Shipyards (1962) 370 U.S. 451 [82 S.Ct. 1380].

The Court of Appeal's erroneous conclusion that it is illegal for insurance buyers to obtain coverage for property and operations in multiple states without using a separate surplus line broker in each state has sent an enormous tremor through this industry.

Additionally, the effect of the Decision goes far beyond simply ensuring that California residents have a convenient forum and enforceable judgments. It will promote forum shopping by litigious multistate businesses who will leap at California's pre-answer bond gambit. Also, it will unfairly prevent reputable insurers from defending suits in California on the merits, even though those insurers have lawfully provided the insurance, have submitted to the personal jurisdiction of California's courts, and in many cases, have also posted financial security in the United States for any judgments against California policyholders. See § 1765.1(b), supra.

[2/] "Any person may negotiate and effect insurance to protect himself, herself, or itself against loss, damage, or liability with any nonadmitted insurer." Ins. Code § 1760(a).

For the foregoing reasons, the SLA requests that this Court grant review.

Respectfully submitted,

/s/

Edgar S. Clark
Executive Director,
The Surplus Line Association of California

APPENDIX S

RULE 29.6 LIST OF PARENT AND SUBSIDIARY COMPANIES

The parent and subsidiary companies of Allianz V.A.G. Munich (n.k.a. Allianz Versicherungs-AG) are as follows:

Allianz AG Holding
Allianz Group
Allianz Allegemeine Rechtsschutzversicherungs-AG
Assecuranz-Co.mpangnie Mercur AG
Bayerische Versicherungsbank AG
Frankfurter Versicherungs-AG
Globus Versicherungs-AG
Kraft Versicherungs-AG

The parent and subsidiary companies of Cie d'Assurances Maritimes Aeriennes et Terrestres SA (CAMAT) are as follows:

Assitalia (INA Group)
AGF

The parent and subsidiary companies of Ancon, UK are as follows:

Exxon Corporation

The parent and subsidiary companies of Bermuda Fire & Marine Insurance Co. Ltd. are as follows:

BF&M Life Insurance Co. Ltd.
Fortress Insurance Co. Ltd.
Hamilton Reinsurance Co. Ltd.
North Atlantic Insurance Company Ltd.
Woodbourne Insurance Ltd.
Bermuda London Underwriting Agency Ltd.
BF& M Management Ltd.
Scarborough Property Holdings Ltd..

The parent and subsidiary companies of British National Insurance Co. Ltd. (n.k.a. North Atlantic Insurance Co. Ltd.) are as follows:

C.I. Services (Holdings) Ltd.
North Atlantic Insurance Co. of Bermuda Ltd.

The parent and subsidiary companies of Brittany Insurance Ltd. are as follows:

Petrofina, SA
Brittany Holdings Ltd.

The parent and subsidiary companies of CNA Reinsurance of London Ltd. are as follows:

Loews Corp
CNA Financial Corp
CNA Management Co. Ltd.

The parent and subsidiary companies of Compagnie Europeenne D'Assurances Industrielles S.A. (CEAI) are as follows:

Petrofina SA

The parent and subsidiary companies of Dominion Insurance Co. Ltd. are as follows:

Fondiaria SpA

The parent and subsidiary companies of Folksam International Insurance Co. (UK) Ltd.are as follows:

Folksam General Mutual Insurance Society of Sweden
Folksam Holdings (U.K.) Limited
Kansa General International Ins. Co. Ltd.
Samvirke Skadeforsikring AS

The parent and subsidiary companies of Generali Insurance Co. are as follows:

Assicurazioni Generali SpA
La Venezia Assicurazioni
Sta Italiana Assicurazione Danni
Trieste e Venezia Assicurazioni
Aurora Assicurazioni
Navale Assicurazioni
Unione Mediterranea di Sicurta
Alleanza Assicurazioni
Friuli-Venezia Giulia Assicurazioni La Carnica
Adria Vita
Assi Ba Sta di Assicurazioni
Agricoltura Assicurazioni Societa Mutta
Risparmio Assicurazioni
Unione Italiana di Riassicurazione
Fincral Finanziamento al Lavoro
Gefina Partecipazioni Finanziarie e Assicurative
Genagricola
Genimmobil Lotto Tre, Prunus, Europ Assistance Italia
EA Rechtsschutz-Versicherung
Europaische Reiseversicherung
Erste Allgemeine Versicherung
CA Generali Versicherung
Generali Allgemeine Lebensversicherung
Generali Ruckversicherung
Interungall Versicherung
La Concorde
Cie Continentale d' Assurances
L' Equite IARD La Federation Continentale and

Europe Assistance
L'Europeenne de Protection Juridique
La Lutece
Generali Krankenversicherung
Generali Lebensversicherung
Deutscher Lloyd Gruppe
Dialog Versicherung
Dialong Lebensversicherungs-AG Interunfall Allgemeine Versicherung Munchener Lebensversicherung
Europaea-Assurance Protection Juridique
Generali Belgium
De Nederlanden van 1870 Co.
Generali Verzekering
Eerste Hollandsche Cos.
Northern Star Insurance Co.
Europa Insurance Co.
Dog Breeders' Insurance Co.
Caja de Prevision y Socorro
Covodonga de Seguros
Banco Vitalicio de Espana
Standard General Insurance Co. Ltd.
Vanguard Insurance Co. Ltd.
Generali do Brasil
Granadina de Seguros Cos.
Aseguradora General
Generali Hellas Generali Life
Anglo Mexicana de Seguros
Union Suisse
Familia Lebensversicherung
Generali Vida
Generali Budapest Biztosito

Generali Sigorto
Providencia Cia de Seguros de Retiro
Providencia Cia Argentina de Seguros
Federation Insurance Co. of Canada
Banco Vitalicio de Espana
Wiener Allianz Lebensversicherung
La Nacional
Atlas
Business Men's Assurance Co. of America
Generali Worldwide Insurance Co.
Transocean Holding Corp
Participatie Mij Graafschap Holland
Gefina International Ltd.
Gefina International NV
Transocean do Brasil
Sao Marcos Empreendimentos e Participacoes Ltd. a
Albula Verwaltung
Beteligungen
La France IARD
Seguros America Banamex
Wiener Allianz Lebensversicherung
Emporiki Insurance Co.
African Development Insurance
World Marine and General Insurances
Migdal Insurance Co.

The parent and subsidiary companies of Heddington Insurance (UK) Ltd. are as follows:

Texaco, Inc.
Texaco Panama Inc.
Heddington Insurance (CIS) Ltd.
Texaco Risk Management (Europe) Ltd.

The parent and subsidiary companies of Ludgate Insurance Company Ltd. are as follows:

RBQ, Ltd.
Ken Randall Associates, Ltd.

The parent and subsidiary companies of Sovereign Marine & General Insurance Co. Ltd. are as follows:

Willis Corron Group plc
Sovereign Insurance (UK) Limited
Greyfriars Insurance Company Limited
Capacity Resources Insurance Company Ltd.

The parent and subsidiary companies of St. Katherine Ins. Co. plc (n.k.a St. Paul International Insurance Co. Ltd.) are as follows:

The St. Paul Companies Inc.
St. Paul (UK) Ltd.
St. Paul Cos. Inc.

The parent and subsidiary companies of Storebrand Insurance Co. Ltd. (n.k.a. Uni-Storebrand Insurance Co. (UK) Ltd.) are as follows:

Storebrand A/S
Uni-Storebrand International Ltd.

The parent and subsidiary companies of Stronghold Insurance Co. Ltd. are as follows:

Norwich Winterthur Holdings Ltd.
Norwich Union Fire Insurance Society Ltd.
Winterthur Swiss Insurance Co. Ltd.
Chiyoda Fire and Marine Insurance Co. Ltd.

The parent and subsidiary companies of Taisho Marine & Fire Insurance Co. Ltd. are as follows:

Mitsui Marine & Fire Insurance Co. Ltd. (n.k.a Mitsui Kaijo Kasai Hoken KK)
Kalmsca Management Ltd.

The parent and subsidiary companies of Tokio Marine & Fire Ins. Co. Ltd. are as follows:

Toyo Claims Research Co. Ltd.
Toyo Business Service Co. Ltd.
Toyo Investment Co. Ltd.
T.M. Management Services Ltd.

The parent and subsidiary companies of Turegum Ins. Co. are as follows:

Zurich Versicherungs-Ges
Zurich Holdings (UK) Ltd.
Cente Reinsurance (Bermuda) Ltd.
Zurich Asia Holdings Ltd.

The parent and subsidiary companies of Yasuda Fire & Marine Ins. Co. (UK) Ltd. (n.k.a. Yasuda Kasai Kaijo Hoken KK) are as follows:

Yasuda Agent Association Ltd.
Yasuda Building Management Co. Ltd.
Yasuda Business Service Co. Ltd.
Yasuda Kasai Career Bureau Co. Ltd.
Yasuda Kasai Claims Research Co. Ltd.
Yasuda Kasai Credit Card Co. Ltd.
Yasuda Kasai Information Technology Co. Ltd.
Yasuda Kasai Fine Arts Foundation
Yasuda Kasai Brinson Investment Management Co. Ltd.
Yasuda Kasai Foundation
Yasuda Loan Service Co. Ltd.
Yasuda Marine Service Co. Ltd.
Yasuda Research Institute Co. Ltd.
Yasuda Kasai System Development Co. Ltd.
Yasuda Training and Planning Co.
Yasuda General Finance Co. Ltd.
Yasuda Kasai Credit Co. Ltd.
Yasuda Kasai Hot Line Service Co. Ltd.
AIR High-Technology Center Co. Ltd.
Yasuda Kasai Well-Aging Life Support Co. Ltd.
Cia de Seguros America do Sul Yasuda
Yasuda Claims Ltd. (UK)
Yasuda Fire & Marine Insurance Co. of America
Yasuda Fire & Marine Insurance Co. of Europe Ltd.
William S.T. Lee Insurance Co. Ltd.
Pan Financial Insurance Co. Ltd.
Yasuda Reinsurance Co. Ltd.

PT Asuransi Yasuda Indonesia
Yasuda International Services Co. Ltd.
Yasuda Claims Service Inc.
Yasuda Re Management Corp
Yasuda do Brasil S/C Ltd.
PGA Yasuda Insurance Company
Yasuda Fire and Marine Insurance Co. (Asia) Pte Ltd.
Yasuda Kasai Insurance Co. of Europe Ltd.
Yasuda Fire Asset Management Co. Ltd.
Yasuda Management Service Co. Ltd.
Yasuda Fire Bahama Ltd.
Yasuda Kasai International (USA) Inc.
Yasuda Kasai Realty Inc.
Yasuda Fire Investment (Europe) SA
Yasuda Management (Singapore) Pte Ltd.
Yasuda Management Service
Yasuda Lloyd's Corporate Member Ltd.

The parent and subsidiary companies of Zurich International (Bermuda) Ltd. are as follows:

Zurich Versicherungs-Ges
Coral Shield Insurance Co. Ltd.

The parent and subsidiary companies of Zurich International (UK) Ltd. are as follows:

Zurich Versicherungs-Ges

Supreme Court, U.S.
FILED
DEC 13 1995
CLERK

No. 95-601

In The

Supreme Court of the United States

October Term, 1995

LOWSLEY-WILLIAMS AND COMPANIES, ET AL.,

Petitioners,

v.

RAYTHEON COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of The State Of California First Appellate District, Division Five

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTIONS RESTATED

1. When an insurer disobeys state law by transacting insurance without a state license, through an unlicensed broker, may the state require the insurer to either obtain an insurance license or else post a bond before the insurer can defend a suit brought on a policy that was issued by the insurer in violation of state law?

2. Have petitioners preserved any substantial constitutional question in view of their concession in the California courts that the Due Process Clause would not be violated if a state insisted that an unlicensed insurer post a bond as a precondition to defending a suit brought on a policy of insurance that was issued illegally, in violation of state insurance law?

3. Does this Court have jurisdiction over an interlocutory state court ruling which determined that petitioners transacted insurance in California, in violation of state law, when it has yet to be determined in state court whether petitioners will purge themselves of the state court ruling by (a) obtaining a state license to transact insurance business, or (b) posting a bond in an amount which remains to be determined in state court after discovery and a further hearing?

RULE 29.6 STATEMENT

Raytheon Company is a publicly held corporation organized under the laws of the State of Delaware with its headquarters located in Lexington, Massachusetts. Ratheon stock is traded on the New York Stock Exchange. None of Raytheon's affiliated or subsidiary entities issues shares to the public.

TABLE OF CONTENTS

Page

QUESTIONS RESTATED i

RULE 29.6 STATEMENT ii

STATEMENT 3

A. California's System of Insurance Regulation 3

B. Background Facts Culminating in Insurance Coverage Litigation in California State Court..... 6

C. Facts Concerning the California Court of Appeal Decision That Petitioners Would Have This Court Review 8

1. Raytheon's Motion in the State Trial Court and the Evidence Relating to That Motion.. 8

2. The State Trial Court's Findings and Order, Including a Description of Further Proceedings Yet to Occur in the State Trial Court Related to the Subject of Raytheon's Motion 10

3. Proceedings in the California Appellate Court Leading to the Written Opinion of the California Court of Appeal..... 11

4. The Actual Decision of the California Court of Appeal, Including the Limits and Analysis in That Decision..... 12

D. Proceedings After the Court of Appeal Decision Leading to the Petition for Writ of Certiorari..... 14

REASONS TO DENY THE WRIT 17

A. Applying the Rule 10(c) Criteria, There Is No Basis for Certiorari. There Is No Conflict with Any Decision of This Court. There Is No Important, Properly Presented Question of Federal Law 17

TABLE OF CONTENTS – Continued

Page

1. A Settled Line of Supreme Court Precedent Is Consistent with the Rulings of the California Courts 18

2. Petitioners' Assertion of a Property Interest Impaired Without Procedural Due Process Is Wishful and Trivial in View of the Rulings of the California Courts 19

3. The Question Presented by the Petition Is Insubstantial in View of Petitioners' Concessions Below that Insurance Code § 1616 Could Be Constitutionally Applied to an Insurance Transaction that Is Unlawful Under State Law 20

4. Petitioners' Current Theory of Constitutional Deprivation Was Waived During Proceedings in State Court..... 22

5. Petitioners' Theory of Constitutional Deprivation Rests on Misapprehensions of Law and Fact 24

6. There Is No Merit in Petitioners' Other Assertions of Conflict with This Court's Precedents..... 25

B. Applying the Rule 10(b) Criteria, There Is No Basis for Certiorari. There Is No Conflict Between the California Court Decision and the Decision of Any Other Court 27

C. Certiorari Should Also Be Denied Because Petitioners Have Not Established Jurisdiction in This Court 28

CONCLUSION 30

INDEX OF AUTHORITIES

Pages

CASES

Bank of San Pedro v. Forbes Westar, Inc., 53 F.3d 273 (9th Cir. 1995) 6, 24

Beck v. Washington, 369 U.S. 541 (1962) 22

Bell v. Burson, 402 U.S. 535 (1971) 25

Board of Regents v. Roth, 408 U.S. 564 (1972) 20

Bothwell v. Buckbee-Mears Co., 275 U.S. 274 (1927) 19

Chattanooga Nat'l Bldg. & Loan Ass'n v. Denson, 189 U.S. 408 (1903) 19

Church of Christ in Lexington v. St. Paul Surplus Lines Ins. Co., 494 N.E.2d 45 (Mass.App.Ct. 1986) 9

Clay v. Sun Ins. Office, Ltd., 377 U.S. 179 (1964) 18

Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949) 28, 29, 30

Connecticut v. Doehr, 501 U.S. 1 (1991) 26

County of Sacramento v. Loeb, 160 Cal.App.3d 446, 206 Cal.Rptr. 626 (1984) 23

Eli Lilly & Co. v. Sav-on-Drugs, Inc., 366 U.S. 276 (1961) 19

Evans v. Unemployment Ins. Appeals Board, 39 Cal.3d 398, 703 P.2d 122, 216 Cal.Rptr. 782 (1985) 24

Fuentes v. Shevin, 407 U.S. 67 (1972) 26

German Alliance Ins. Co. v. Lewis, 233 U.S. 389 (1914) 3

INDEX OF AUTHORITIES – Continued

Page

Hitachi Zosen Clearing, Inc. v. Tek-Matik, Inc., 846 F.2d 27 (6th Cir. 1988) 30

Hoopeston Canning Co. v. Cullen, 318 U.S. 313 (1943) 18

Interstate Amusement Co. v. Albert, 239 U.S. 560 (1916) 19

Isaacson v. California Ins. Guar. Ass'n, 44 Cal.3d 775, 750 P.2d 297, 244 Cal.Rptr. 655 (1988) 5

Kowis v. Howard, 3 Cal.4th 888, 838 P.2d 250, 12 Cal.Rptr.2d 728 (1992) 11

Mid-American Indemnity Ins. Co. v. King, 1995 Tex. LEXIS 123 (Tex. July 7, 1995) 27

Osborn v. Ozlin, 310 U.S. 53 (1940) 18

Ownbey v. Morgan, 256 U.S. 94 (1921) 26

Perry v. Sindermann, 408 U.S. 593 (1972) 15, 23

Popelka, Allard, McCowen & Jones v. Superior Court, 107 Cal.App.3d 496, 165 Cal.Rptr. 748 (1980) 12

Richmond v. Dart Industries, Inc., 196 Cal.App.3d 869, 242 Cal.Rptr. 184 (1987) 22

Sniadach v. Family Finance Corp., 395 U.S. 337 (1969) 26

State Board of Ins. v. Todd Shipyards, 370 U.S. 451 (1962) 26

Trihedron Int'l Assurance, Ltd. v. Superior Court, 218 Cal.App.3d 934, 267 Cal.Rptr. 418 (1990) .. *passim*

Union Brokerage Co. v. Jensen, 322 U.S. 202 (1944) 19

INDEX OF AUTHORITIES – Continued

Page

United States v. James Daniel Good Real Property, 114 S.Ct. 492, 126 L.Ed.2d 490 (1993) 26

Watson v. Employers Liability Assurance Corp., 348 U.S. 66 (1954) 18

STATUTES & RULES

15 U.S.C. § 1012(a) 4

28 U.S.C. § 1257 28

28 U.S.C. § 1291 28

U.S. Supreme Court Rule 15.2 3

California Code of Civil Procedure

§ 1033.5(a)(6) 27

California Rules of Court

Rule 977(a) 1

California Insurance Code

§ 35 5

§ 700 5

§ 700.01 5

§ 700.05 5

§ 700(a) 4

§ 703 4

§ 1611 4

§ 1616 ..... *passim*

INDEX OF AUTHORITIES – Continued

Page

§ 1620(a) 9
§ 1760.5 9
§ 1761 ..... 6, 9
§ 1763 ..... 6, 9
§ 1764.1 6
§ 1765 6
§ 1768 6
§ 1770 6
§ 1774 6
§ 1775.5 6

BRIEF FOR RESPONDENT IN OPPOSITION

The petition does not present any substantial, properly preserved constitutional question.

The unpublished, non-precedential decision of the California Court of Appeal in this case is not in conflict with any other, lower court decision.[1] More than forty states have statutes that require an insurance company to post a bond or obtain a license when a policyholder sues a carrier who has transacted unlicensed insurance business within the state in violation of state insurance law. The lower courts have consistently held such statutes to be constitutional.

This Court's due process precedents are in full accord. States may, under the Due Process Clause, (a) condition the transaction of insurance on state licensing, (b) penalize unlicensed insurance transactions, and (c) close state courts to insurers who assert rights under insurance transactions that were not conducted in compliance with state insurance laws.

The petition simply ignores what the California courts determined state law to be. The California courts ruled that petitioners transacted insurance business in California even though they did not meet the requirements of state insurance law. In particular, the California courts specifically determined that petitioners were not qualified under California law to transact insurance as

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[1] "An opinion that is not ordered published shall not be cited or relied on by a court or party in any other action or proceeding except as provided in subdivision (b)." Rule 977(a), Cal. Rules of Court.

unlicensed, surplus line insurers. These determinations of state law are controlling. They establish that petitioners do not now have, and never have had, any "right" to transact surplus line insurance in California. California could not unconstitutionally impair a non-existent "right." California has simply asserted its undoubted power to regulate the insurance business and curtail violations of state insurance licensing laws. California only exercised that power after petitioners had a full hearing, with evidence, on the question of whether they violated California's insurance laws.

If statutes closing courts to unlicensed insurers did present, potentially, some question under the Fourteenth Amendment, petitioners have not preserved any such question for this Court's review. Petitioners conceded in the California courts that the state could constitutionally require an insurance company to obtain a license or post a bond before defending a suit on a policy that was illegally issued, in violation of state law. Thus, when the California courts specifically found that petitioners "transacted" insurance in violation of California law, petitioners' constitutional claim was washed away by their own concession about the reach of the Fourteenth Amendment.

Finally, petitioners have failed to demonstrate that this Court has jurisdiction over the petition. Thus far, the California courts have determined that petitioners transacted insurance in California in violation of state law regulating insurers. If petitioners secured a license to transact insurance business, petitioners would not need to post any bond. And even if petitioners do not obtain a

license, the California courts have yet to decide what the amount of any posted surety bond would have to be. Nothing in the record indicates that any bond, even a large one, would actually impair in any way petitioners' ability to defend themselves. In fact, under California law, if petitioners post a surety bond, and prevail in the state court litigation, they may recover the cost of the bond premium.

For these and other reasons, discussed more fully below, the petition should be denied.

STATEMENT

The petition contains incomplete and inaccurate statements about California law, the course of proceedings in the California courts, and the findings of fact that formed the basis for the interlocutory order that petitioners would have this Court review. Rule 15.2 requires a more accurate and complete description of proceedings in the California courts.

A. California's System of Insurance Regulation

Petitioners are Lloyd's, London underwriters and London Market Insurance Companies who sell commercial liability insurance for profit. States have broad police power to regulate commercial business activities. Such state power is most far-reaching when the business implicates the public interest, as insurance does. *See German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 413 (1914). States can and do impose close regulation of various aspects of

the insurance business, ranging from solicitation of potential policyholders to the investigation and payment of claims.[2]

California regulates the insurance business through a comprehensive statutory scheme contained in the California Insurance Code.[3] All "transaction" of insurance in California is *unlawful* except to the extent authorized by statute. *See* Insurance Code §§ 700(a), 703. Insurance Code § 1611 lists acts that "involve transacting insurance in California":[4]

> (1) The issuance or delivery to residents of, or to corporations authorized to do business in, this State of contracts of insurance insuring (a) the lives or persons of residents of this State physically present herein at the time of such issuance or delivery or (b) property or operations located in this State.
>
> (2) The solicitation of applications for such contracts.

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[2] Congress has sanctioned broad state power over the insurance business by enacting the McCarran-Ferguson Act. The Act eliminates any argument that state regulation of insurance unduly burdens interstate commerce. *See* 15 U.S.C. § 1012(a).

[3] We reprint in an appendix certain sections from the California Insurance Code that are important to an understanding of this case and not otherwise quoted in the text of this brief. The appendix to the petition is cited as "App."

[4] *Trihedron Int'l Assurance, Ltd. v. Superior Court*, 218 Cal.App.3d 934, 945, 267 Cal.Rptr. 418 (1990), held that Insurance Code § 1611 lists acts constituting transaction of insurance in California.

(3) The collection of premiums, membership fees, assessments or other considerations for such contracts.

(4) Any other transaction of business arising out of such contracts.[5]

An insurer can acquire the right to transact insurance in California by obtaining "admission" (a license) from the California Insurance Commissioner. *See* Insurance Code § 700. An *admitted* insurance carrier must maintain minimum capitalization, file periodic reports with the Commissioner, pay taxes on premium income, and pay assessments to the California Insurance Guarantee Association (CIGA). *See* Insurance Code §§ 700.01, 700.05; *Isaacson v. California Ins. Guar. Ass'n*, 44 Cal.3d 775, 784, 750 P.2d 297, 244 Cal.Rptr. 655 (1988). CIGA provides insurance protection to Californians who have the misfortune of holding insurance policies issued by insolvent, admitted carriers. Thus, by requiring insurers to be licensed or admitted, California assures the broadest participation in the state program protecting policyholders against insurer insolvency.

In one circumstance, insurance may be lawfully transacted in California even though the insurer who issues the policy is not admitted (licensed) by the Insurance Commissioner. This is possible when the facts of the

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[5] "Transaction" of insurance is also defined in Insurance Code § 35. "Transaction" includes: (a) Solicitation. (b) Negotiations preliminary to execution. (c) Execution of a contract of insurance. (d) Transaction of matters subsequent to execution of the contract and arising out of it."

transaction fall within a statutory "safe harbor" covering the transaction of surplus line insurance.

California regulates surplus line insurance transactions by licensing and regulating *the brokers* who place the insurance with the unlicensed or nonadmitted carriers. Under California law, a surplus line insurance transaction with a nonadmitted insurer is only proper if the surplus line broker has been licensed by the California Insurance Commissioner. Insurance Code §§ 1761, 1763, 1765; *Bank of San Pedro v. Forbes Westar, Inc.*, 53 F.3d 273, 276 (9th Cir. 1995). In addition to the necessity of using a licensed broker, California places other restrictions on surplus line insurance placements. For example, the broker must prepare and maintain reports concerning the sale of surplus line policies. The broker must pay quarterly taxes based on premiums received from the sale of such policies. Issued surplus line policies must satisfy various form and content requirements. And before selling a surplus line policy, the broker must attempt, unsuccessfully, to place the coverage with a carrier who is admitted to transact insurance in California. *See* Insurance Code §§ 1763, 1764.1, 1768, 1770, 1774, 1775.5.[6]

B. Background Facts Culminating in Insurance Coverage Litigation in California State Court

Raytheon Company is headquartered in Massachusetts. Since 1944, Raytheon has done business in California. Raytheon's semiconductor facility in the San

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[6] The surplus line broker must also satisfy various licensing requirements. *See, e.g.*, Insurance Code § 1765.

Francisco Bay Area, at Mountain View, employed 850 people and generated over $90 million in sales in 1992. App. 11a-12a.

Raytheon faces claims of liability as a result of environmental contamination allegedly present at the Mountain View facility. Raytheon tendered these claims to its insurer, Continental Casualty Company. Continental had issued to Raytheon primary and first-level excess liability insurance policies providing $10 million worth of coverage for the period April 1, 1984 to April 1, 1985. Continental investigated Raytheon's claims and made payments on Raytheon's behalf, exhausting the limits of the Continental policies. App. 12a; R014:15-23.[7]

Raytheon estimates that its liability for contamination at the Mountain View facility totals $40 million. When the limits of the Continental policies were exhausted, Raytheon tendered the claims to petitioners, who issued policies of insurance excess to the Continental policies. Petitioners' policies incorporated the terms of the Continental policies. Thus, as a general proposition, if the Continental policies provided coverage, petitioners' policies would also provide coverage. *See* App. 13a; R012.

Petitioners refused to acknowledge coverage. Therefore, Raytheon filed suit in California state court, at San Francisco, seeking a declaratory judgment that petitioners must cover Raytheon for the environmental contamination claims that have arisen from the operations at Mountain View. App. 13a.

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[7] Citations to "R___" are to the record filed by petitioners in the California Court of Appeal.

C. Facts Concerning the California Court of Appeal Decision That Petitioners Would Have This Court Review

1. Raytheon's Motion in the State Trial Court and the Evidence Relating to That Motion

As Lloyd's, London underwriters and London Market insurance companies, none of the petitioners is admitted to transact insurance in California. Petitioners' policies were obtained for Raytheon through an insurance broker, Frank B. Hall & Co. of Massachusetts, Inc. In 1984, when the policies were issued, Hall was licensed as a surplus line insurance broker in Massachusetts, but not in California. App. 12a, 14a.

After Raytheon filed the underlying suit for coverage, petitioners consented to jurisdiction by filing a general appearance and an answer in California state court. App. 13a. Thereupon, Raytheon filed a motion under Insurance Code § 1616, which provides:

> Before any nonadmitted foreign or alien insurer shall file or cause to be filed any pleading in any action, suit or proceeding instituted against it, the insurer shall either (1) procure a certificate of authority to transact insurance in this state; or (2) give a bond in the action, suit or proceeding in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in the action, suit, or proceeding.

Raytheon asked the state trial court to require petitioners to come into compliance with § 1616. In support of the motion, Raytheon adduced facts showing that petitioners had transacted insurance in California without a proper

license when they issued and later administered the insurance policies at issue in Raytheon's suit for coverage. R280, 297.

Petitioners opposed the motion. They argued, among other things, that Insurance Code § 1616 did not apply. Insurance Code § 1620(a) exempts from Insurance Code § 1616 insurance sold in compliance with Insurance Code §§ 1760.5 and 1763. Sections 1760.5 and 1763 codify California law covering the lawful placement of surplus line insurance. R425-27.

However, petitioners failed in their effort to bring themselves under a surplus line exception to Insurance Code § 1616. Petitioners did not demonstrate in the record that their policies were issued in compliance with the specific, statutory prerequisites to a lawful, surplus line placement. Most notably, petitioners were forced to concede that the policies were not placed "by and through a surplus line broker licensed under" the chapter of the California Insurance Code dealing with surplus line brokers. *See* Insurance Code § 1761; R426.

Petitioners' opposition also fell short in another regard. Petitioners did not show that their policies were placed in conformity with the law of Massachusetts governing surplus line insurance. The demonstration that Hall was licensed in Massachusetts as a broker speaks to only one of several requirements that Massachusetts imposes on the transaction of surplus line insurance.[8]

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[8] Some of the requirements of the Massachusetts surplus line insurance law are described in *Church of Christ in Lexington v. St. Paul Surplus Lines Ins. Co.*, 494 N.E.2d 45, 46 (Mass.App.Ct. 1986).

2. The State Trial Court's Findings and Order, Including a Description of Further Proceedings Yet to Occur in the State Trial Court Related to the Subject of Raytheon's Motion

The state trial court held two hearings and issued a written order. The court held that Insurance Code § 1616 applied because petitioners had in fact "transacted" insurance business in California when they issued the policies to Raytheon and later, when claims under those policies arose in California. In addition, while the court's order is silent on the subject, the court necessarily rejected petitioners' argument that Insurance Code § 1616 was inapplicable because the policies sold to Raytheon were surplus line insurance policies that were exempt from the California law requirement that the insurer be an admitted insurer. App. 2a.

The trial court determination that Insurance Code § 1616 applies is a threshold determination or interlocutory step toward final resolution of the issues raised by Raytheon's § 1616 motion. Further proceedings must still occur in the California trial court. First, § 1616 gives petitioners the option of securing admission (a license) from the Insurance Commissioner *or* posting a bond. Second, the state trial court has not as yet decided what the amount of any bond should be. The court granted petitioners discovery and continued to a later time the hearing on the amount of any bond that will have to be posted in the event petitioners do not secure admission to do insurance business in California. App. 3a.

3. Proceedings in the California Appellate Court Leading to the Written Opinion of the California Court of Appeal

Petitioners did not wait to let the trial court complete its work on the issues raised by Raytheon's § 1616 motion. Instead, the insurers filed a petition for writ of mandate seeking discretionary, interlocutory review from the California Court of Appeal, First Appellate District. The petition presented several arguments, one of which was that, under California law, Insurance Code § 1616 should not apply because the insurance at issue was surplus line insurance sold in Massachusetts to Raytheon, a company headquartered there.

The court of appeal denied the petition for writ of mandate with a statement of reasons. App. 6a. However, under California law, the summary denial of a petition for writ of mandate is not an expression on the merits of the issues tendered by the petition. *Kowis v. Howard*, 3 Cal.4th 888, 838 P.2d 250, 12 Cal.Rptr.2d 728 (1992).

Petitioners then filed a petition for review with the California Supreme Court. However, petitioners did not seek review of any issue of California law. In particular, petitioners did not pursue their argument that Insurance Code § 1616 was inapplicable because the insurance at issue was surplus line insurance and thus exempt from § 1616. App. 16a & n.6.

The California Supreme Court granted review and transferred the case back to the court of appeal with directions to that court to hear and decide the matter. Under California law, such an order is not an expression on the merits of any issue presented to the California

Supreme Court. *Popelka, Allard, McCowen & Jones v. Superior Court*, 107 Cal.App.3d 496, 500, 165 Cal.Rptr. 748 (1980).

4. The Actual Decision of the California Court of Appeal, Including the Limits and Analysis in That Decision

The legal analysis in the court of appeal opinion begins by pointing out that petitioners had presented at one time, but had thereafter waived, certain arguments concerning the interpretation of California insurance law. Waiver occurred under California appellate practice when petitioners failed to present to the California Supreme Court in the petition for review non-constitutional arguments resting on the proper interpretation of state law. App. 16a & n.6. One of the "waived issues" of California law is described in the opinion as the "Surplus Line Exemption to Section 1616." The court of appeal deemed it established that petitioners had not complied with California law validating surplus line placements of insurance. Per the court of appeal, petitioners "cannot claim exemption from section 1616, and their status under California law is that of nonadmitted insurers." App. 21a.

On another matter of appellate preservation, the court of appeal noted the existence of a "factual dispute over whether Hall procured the insurance in compliance with Massachusetts surplus line law . . . . " App. 20a & n.9. The record in this case does not show compliance with Massachusetts law.

Thereupon, the court of appeal addressed the only issue presented, namely, a due process challenge to the application of Insurance Code § 1616 to petitioners. App. 21a. Here, again, some care is needed to frame the issue that was preserved, presented, and decided. Petitioners did not argue that Insurance Code § 1616 is facially unconstitutional. In fact, petitioners conceded in briefs they filed that unlicensed insurers could be required to post bonds under § 1616. They told the California courts that a prior California court decision *(Trihedron Int'l Assurance, Ltd. v. Superior Court)* "was sound based on the facts of that case."[9] In *Trihedron*, a different panel of the California Court of Appeal held that Insurance Code § 1616 did not violate the Due Process Clause, either facially or as applied to a nonadmitted insurance company that sold insurance directly to a Californian, without the use of any broker. 218 Cal.App.3d at 946-48.

In view of these concessions, the narrow issue that the court of appeal took up was whether *Trihedron* was distinguishable. The court held *Trihedron* was not distinguishable because petitioners, like the insurer in *Trihedron*, had transacted insurance in California but had not complied with California law. In order to lawfully transact insurance in California, petitioners should have either obtained admission or complied with the California law requirements for placement of surplus line insurance. Petitioners did neither. Therefore, Insurance Code § 1616 applied to them. App. 24a.

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[9] This quotation is taken from page 13 of a Supplemental Brief that petitioners filed with the California Court of Appeal on August 22, 1994. *See also* App. 23a & n.12.

Once the court of appeal decided that the *Trihedron* precedent could not be distinguished, the case was over because petitioners had conceded that *Trihedron* correctly analyzed the application of the Due Process Clause to § 1616. As the court of appeal noted: "[Petitioners] do not argue that *Trihedron* was wrongly decided." App. 23a & n.12.

D. Proceedings After the Court of Appeal Decision Leading to the Petition for Writ of Certiorari

After the court of appeal opinion was filed, an attorney for the California Department of Justice applied to the court of appeal for leave to submit a letter in support of the petition for rehearing. App. 29a. The letter urged the court of appeal to delete seven sentences from the opinion. The letter said that the California Department of Insurance had "communicated to the industry that a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements." App. 33a-34a.

This letter, generated at the time of rehearing in the court of appeal, marks the first time anyone ever suggested that an uncodified, unwritten, "mutual understanding" existed between surplus line insurers and state insurance regulators excusing insurers from any need to comply with parts of the California Insurance Code specifying how surplus line insurance should be placed.

The court of appeal refused to accept the letter for filing. This was an understandable ruling. App. 26a. The

court of appeal had just held in the written opinion that petitioners had waived their right to argue that they fell within a surplus line insurance exception to the application of Insurance Code § 1616. App. 19a. Any argument about a "mutual understanding" of the meaning of California insurance law was no longer open to petitioners because they had waived such an argument nearly a year earlier, when they petitioned the California Supreme Court for review and gave up at that time all of their claims based on the proper interpretation of state insurance law. *See* App. 16a & n.6.

Apart from waiver under state appellate court procedures, petitioners also faced the problem that they had never contended in the trial court that the Department of Insurance and surplus line insurers had a "mutual understanding." No evidence or indicia of this "mutual understanding," its source, content, scope, or application was ever developed. This Court's precedents indicate that a Fourteenth Amendment "property" right, when based on an "understanding," should be established through a fully developed factual record. *See, e.g., Perry v. Sindermann*, 408 U.S. 593 602, 603 (1972) (this Court refers to "other relevant facts" showing an entitlement and to "proof of such a property interest"). There is no record here.

This belated letter that was refused filing presents petitioners with a further problem, gingerly mentioned by them in a footnote. The letter *did not* assert that the court of appeal reached an erroneous result. On the contrary, the letter said that the language of the opinion should be modified because that language "is not necessary in reaching [the court of appeal's] holding that a

bond was required under Insurance Code section 1616." App. 34a. Thus, insofar as the letter was an attempt to convey a state insurance regulator's view to the state court of appeal, that court was plainly told that it had reached the right result and correctly applied Insurance Code § 1616 to the petitioners.

The court of appeal denied rehearing. App. 26a. Petitioners filed another petition for review with the California Supreme Court. They continued to press their very narrow line of argument. Again, as they had done in the court of appeal, petitioners endorsed the due process analysis of the *Trihedron* decision as correct, and sought only to distinguish themselves from *Trihedron* on a factual basis.[10]

Petitioners made other tactical decisions in their second petition for review. They did not seek California

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[10] Petitioners wrote the following in their petition to the California Supreme Court, dated June 5, 1995 (pp. 13-14):

> The holding of *Trihedron* is premised on [Insurance Code] section 700's requirement that nonadmitted insurers transacting insurance in California were required to be admitted at the time they issued the policies. As to nonadmitted insurers illegally transacting business in California, *Trihedron* correctly held that [Insurance Code] section 1616 did "not deprive insurers of any substantial interest or existing right," but rather simply "encourage[d] compliance with the *already existing* statutory mandate." *Trihedron*, 218 Cal.App.3d at 948 (emphasis added). A requirement that a party comply with a pre-existing statutory obligation does not involve a deprivation of any property interest since there can be no property right premised on a violation of the law. [Citation omitted].

Supreme Court review of the court of appeal's holding that they had waived any right to contest the interpretation of California insurance law. Further, petitioners did not contest the court of appeal's order refusing to file the letter that supposedly espoused a "mutual understanding" of California insurance law shared with insurers by state regulators. Of significance on that matter, while petitioners rounded up other surplus line insurers, and persuaded them to send to the California Supreme Court self-serving letters in support of review, California insurance regulators did not send any letter to the Supreme Court or express any opposition to the decision of the court of appeal.

The petition was unsuccessful. The California Supreme Court denied review, and a timely petition for writ of certiorari was filed with this Court. App. 28a.

REASONS TO DENY THE WRIT

A. Applying the Rule 10(c) Criteria, There Is No Basis for Certiorari. There Is No Conflict with Any Decision of This Court. There Is No Important, Properly Presented Question of Federal Law.

Petitioners contend that the court of appeal decision conflicts with cases from this Court requiring predeprivation hearings before property rights are taken or impaired. This argument misstates this Court's precedents and rests on a mischaracterization of the findings of fact and conclusions of California law adopted by the California courts.

1. A Settled Line of Supreme Court Precedent Is Consistent with the Rulings of the California Courts

This Court has held that no person has a liberty or property right to transact insurance in any state. States can exclude persons entirely from transacting any insurance within state borders. In lieu of total exclusion, states may impose all manner of lesser restrictions. As Justice Frankfurter wrote for the Court, in *Osborn v. Ozlin*, 310 U.S. 53, 66 (1940):

> In the light of all these exertions of state power it does not seem possible to doubt that the state could, if it chose, go into the insurance business, just as it can operate warehouses, flour mills, and other business ventures, . . . or might take "the whole business of banking under its control," . . . . If the state, as to local risks, could thus preempt the field of insurance for itself, it may stay its intervention short of such a drastic step by insisting that its own residents shall have a share in devising and safeguarding protection against its local hazards.[11]

California also has the power to arrest violations of state insurance law that have already occurred. One way California may exercise this power is by closing state courts to persons who transact unlicensed business activities in violation of state law. This Court has consistently

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[11] *See also Hoopeston Canning Co. v. Cullen*, 318 U.S. 313, 316 (1943); *Watson v. Employers Liability Assurance Corp.*, 348 U.S. 66, 72-73 (1954); *Clay v. Sun Ins. Office, Ltd.*, 377 U.S. 179, 181-82 (1964).

upheld the constitutionality of state statutes closing state civil courts to unlicensed businesses.[12]

This power was directly applied to unlicensed insurance companies by Justice Brandeis' opinion in *Bothwell v. Buckbee-Mears Co.*, 275 U.S. 274, 277 (1927):

> Minnesota had the power to prohibit the Employers' Mutual Co. from doing business within the State without first complying with the prescribed conditions, and could refuse the aid of its courts in enforcing a contract which involved violation of its laws. . . .

The California courts acted within these precedents. They applied Insurance Code § 1616 to a case concerning insurance policies that were issued in violation of California law. They reached decision after a hearing and evidence showing that petitioners repeatedly transacted insurance in California in violation of specific requirements of California insurance law.

2. Petitioners' Assertion of a Property Interest Impaired Without Procedural Due Process Is Wishful and Trivial in View of the Rulings of the California Courts

A Fourteenth Amendment procedural due process claim presupposes a property or liberty interest that has been taken or impaired without an adequate hearing.

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[12] *See, e.g., Interstate Amusement Co. v. Albert*, 239 U.S. 560, 568 (1916); *Chattanooga Nat'l Bldg. & Loan Ass'n v. Denson*, 189 U.S. 408, 417 (1903); *see also Eli Lilly & Co. v. Sav-on-Drugs, Inc.*, 366 U.S. 276, 279-81 (1961); *Union Brokerage Co. v. Jensen*, 322 U.S. 202, 210 (1944).

Petitioners' claim to this Court's review is wishful and trivial because the California courts decided under state law that no property or liberty interest ever allowed petitioners to deal in insurance in California.

Petitioners argue in this Court that they had a property right to transact insurance in California based on a supposed "mutual understanding" between the surplus line insurance industry and the California Department of Insurance. Thus, petitioners say that, by applying § 1616 to them, California is taking away, without an adequate hearing, a supposed property right to transact unlicensed insurance, allegedly conferred by a "mutual understanding" between California insurance regulators and surplus line insurers.

This argument is foreclosed. The existence of a property right under the Fourteenth Amendment is a question of state law. *See, e.g., Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). The California courts held that, under state law, petitioners had no right to transact insurance in California on *any* basis, including on a surplus line basis. The state courts determined that petitioners were not, at any time, entitled to transact insurance under state law.

3. The Question Presented by the Petition Is Insubstantial in View of Petitioners' Concessions Below that Insurance Code § 1616 Could Be Constitutionally Applied to an Insurance Transaction that Is Unlawful Under State Law.

Petitioners have not preserved for this Court's review a substantial question of constitutional law. Theirs has

always been a fact-oriented squabble, framed by their concession that Insurance Code § 1616 is generally constitutional under the Due Process Clause.

The California Court of Appeal held that the *Trihedron* case applied to petitioners. App. 23a-24a. Petitioners admitted below, at least twice, that *Trihedron* was correctly decided. *Trihedron* held that Insurance Code § 1616 is facially constitutional under the Due Process Clause. *Trihedron* also held that § 1616 was constitutional as applied to a foreign insurer who transacted insurance in California illegally, by mail, without a license. 218 Cal.App.3d at 946-48.

By conceding that *Trihedron* is correct whenever applied to the "illegal" transaction of insurance in California, petitioners failed to preserve for this Court's consideration any substantial legal issue under the Due Process Clause. Petitioners' transaction of insurance was no less "illegal." As the court of appeal explained: "the issuance of the policies in the present case is just as 'illegal' as in *Trihedron*. By 'illegal,' [petitioners] mean the policies were issued to California insured by a nonadmitted insurer. That is exactly the case herein." App. 24a.

This Court does not sit to apply settled law to distinctive facts. By admitting that Insurance Code § 1616 could be constitutionally applied to the transaction of insurance in violation of state law, petitioners drained from this case any substantial question of constitutional law.

4. Petitioners' Current Theory of Constitutional Deprivation Was Waived During Proceedings in State Court

Of course, this Court is in no position to disregard the determinations of California law adopted by the California courts. Of equal importance, petitioners have waived the claim that they have a "right" to transact surplus line insurance in California. They base their "right" on a supposed "mutual understanding" with California insurance regulators. But this argument was waived when it was not presented in proper fashion to the California courts.

California courts deem an argument waived if it is not presented in the trial court and renewed in the appellate court. *See, e.g., Richmond v. Dart Industries, Inc.*, 196 Cal.App.3d 869, 874, 242 Cal.Rptr. 184 (1987). This Court honors and enforces state law waiver principles when considering a certiorari petition. *See, e.g., Beck v. Washington*, 369 U.S. 541, 549-54 (1962).

Petitioners never presented to the state trial court any argument, evidence, or indicia of a "mutual understanding" about surplus line insurance regulation that would be relevant to the application of § 1616. Petitioners have never cited, and do not now cite, any California statute, rule, regulation, or precedent that embodies or refers to such a mutual understanding. Waiver under California law is thereby established.

This Court's own precedents cut further against certiorari. When a Fourteenth Amendment property interest is claimed to rest on a "mutual understanding," evidence of the existence of the understanding must be adduced.

See Perry v. Sindermann, 408 U.S. at 601, 602, 603. There is no evidence here. This Court should not render a constitutional adjudication when the record lacks facts that would be necessary to frame the constitutional issue.

There is more. The California Court of Appeal opinion does not discuss any "mutual understanding" of state insurance law. The opinion is silent because petitioners did not claim there to be a "mutual understanding" giving rise to a right to transact unlicensed insurance.[13]

Petitioners' waiver is broader than just a failure to articulate a theory of state insurance law favorable to them. The court of appeal held that petitioners had waived, under state appellate procedure, the right to pursue any arguments based on the interpretation of state insurance laws. Included within this waiver is any argument challenging petitioners' status as non-admitted insurers who had failed to comply with California surplus line insurance laws. App. 21a. And petitioners acquiesced in this waiver holding; they did not challenge this holding in their second petition to the California Supreme Court.

No better demonstration of waiver can be found than this: petitioners' belated "mutual understanding" argument is based entirely on material that is extraneous to the record. The claimed "mutual understanding" is set

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[13] The submission of a letter from a non-party in support of a petition for rehearing does not constitute preservation of an argument under California appellate procedure. *See, e.g., County of Sacramento v. Loeb*, 160 Cal.App.3d 446, 459-60 n.5, 206 Cal.Rptr. 626 (1984).

out in a letter that the court of appeal refused to accept for filing. App. 26a.

5. Petitioners' Theory of Constitutional Deprivation Rests on Misapprehensions of Law and Fact

Waiver aside, petitioners' "mutual understanding" argument is flawed in its substance.

The California Insurance Code specifies that unlicensed surplus line insurers may only operate in California through California-licensed brokers. Both in this case, and in a recent Ninth Circuit opinion, the courts have held this to be a mandatory feature of California's Insurance Code. *See Bank of San Pedro*, 53 F.3d at 276. A California administrative agency could not adopt an "understanding" of state law that is contrary to a state statute. *See Evans v. Unemployment Ins. Appeals Board*, 39 Cal.3d 398, 407, 703 P.2d 122, 216 Cal.Rptr. 782 (1985). The "mutual understanding" claimed by petitioners is dubious and counter-intuitive because it is contrary to the California Insurance Code.

In any event, even if a mutual understanding existed, it does petitioners no good. Petitioners never demonstrated that they placed insurance in conformity with the surplus line insurance requirements of Massachusetts law. Assuming, *arguendo*, that California would stay its regulatory hand in a case where surplus line insurers complied with the law of another state, petitioner did not show their compliance with any other state's law. Perhaps this is one reason why the infamous letter containing the supposed "mutual understanding" also advised

that the state court of appeal had reached the correct outcome by applying Insurance Code § 1616 to petitioners.

6. There Is No Merit in Petitioners' Other Assertions of Conflict with This Court's Precedents

Petitioners cite several precedents that are entirely inapt. In *Bell v. Burson*, 402 U.S. 535 (1971), for example, the issue concerned the process due before the state could require an uninsured *but licensed* driver to post a bond following an automobile accident. Justice Brennan emphasized that the state could refuse to issue a driver's license in the first instance to uninsured persons. *Bell* establishes a difference of constitutional dimension between state power over unlicensed persons and state power to revoke a license that has already been granted. Petitioners concede as much. They say that they fit within the *Bell* precedent because they claim to have had a "license to issue surplus line insurance. . . . " Of course, that assertion is not supported and is contrary to the determination of the California courts. Furthermore, as the court of appeal noted, the "*Bell* argument" was never raised in the California trial court. *See* App. 19a & n.8.

Petitioners discuss "exigent circumstances" and the need, in cases of exigency, for a prompt post-deprivation hearing when property rights are affected. None of these cases are material. These cases presuppose an existing liberty or property interest that is taken or impaired. Petitioners have no such interest.

Also distinguishable are this Court's cases involving attachments and property seizures.[14] None of these cases involved unlicensed persons engaging in sensitive business activities in violation of state licensing law.

Petitioners abandoned in the California courts their argument that the application of Insurance Code § 1616 somehow represented an unwarranted, extraterritorial application of California insurance law, in violation of the Due Process Clause. *See* App. 19a; *State Board of Ins. v. Todd Shipyards*, 370 U.S. 451 (1962).

Petitioners imply in a footnote that the constitutionality of Insurance Code § 1616 rests on the pedigree of a tarnished case, *Ownbey v. Morgan*, 256 U.S. 94 (1921). *See* App. 241 & n.19. Of course, petitioners conceded below the facial constitutionality of Insurance Code § 1616, leaving one wondering about the point of their citation to *Ownbey*. *See* App. 23a & n.12. In any event, since *Ownbey*, this Court has embraced the power of states to regulate insurance. Whatever the continued vitality of *Ownbey*, § 1616 is a lawful exercise of state police power over the insurance business.

Finally, petitioners claim that the unpublished decision here might jeopardize the surplus line insurance industry. In support, petitioners cite statements by surplus line insurers. App. 36a-100a. Apart from the obvious bias, there are no facts supporting the gloomy forecast.

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[14] *See, e.g., Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969); *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Connecticut v. Doehr*, 501 U.S. 1 (1991); *United States v. James Daniel Good Real Property*, 114 S.Ct. 492, 126 L.Ed.2d 490 (1993).

For example, petitioners' complaint about the theoretical cost of surety bond premiums in this case overlooks the fact that petitioners can recover this expense under California law if they prevail in the underlying insurance coverage litigation. *See* California Code of Civil Procedure § 1033.5(a)(6). Moreover, petitioners' dire lamentations assume that unlicensed insurers will opt to post bonds, rather than obtain licenses. The petition fails to explain why the surplus line insurance industry is unable or incapable of obtaining state admission or functioning through state-licensed brokers.[15]

B. Applying the Rule 10(b) Criteria, There Is No Basis for Certiorari. There Is No Conflict Between the California Court Decision and the Decision of Any Other Court.

Petitioners do not claim that the court of appeal's unpublished, non-precedential decision is in conflict with the decision in any other case. In fact, lower courts have consistently upheld the constitutionality of Insurance Code § 1616 and other, similar state statutes.[16]

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[15] Petitioners argue that individual underwriters are ineligible to be admitted insurers in California because they are not incorporated. This point has negligible significance. Approximately 90% of the coverage at issue was written by London Market insurance *companies*, not individual underwriters. Moreover, as for individuals, the adoption of an incorporated business form can be done with relative ease.

[16] *See Trihedron*, 218 Cal.App.3d 934 (1990); *Mid-American Indemnity Ins. Co. v. King*, 1995 Tex. LEXIS 123 (Tex. July 7, 1995).

C. Certiorari Should Also Be Denied Because Petitioners Have Not Established Jurisdiction in This Court

Another reason to deny certiorari is petitioners' inability to establish this Court's jurisdiction.

This Court may review the "final judgments or decrees" of a state's highest court. *See* 28 U.S.C. § 1257. "Finality" is a question of federal law.

Petitioners claim jurisdiction under the decision in *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949). *Cohen* involved a trial court order refusing to require the plaintiff to post security. Justice Jackson identified two key hallmarks of a final decision. *First*, the rule of finality "disallow[s] appeal from any decision which is tentative, informal, or incomplete. * * * So long as the matter remains open, unfinished, or inconclusive, there may be no intrusion by appeal." *Second*, the requisite finality is missing, "even from fully consummated decisions, where they are all but steps towards final judgment in which they will merge." *Id.* at 546. *Cohen* held that an order refusing to require a plaintiff in a shareholder derivative action to post security was "final" and appealable under federal law as the final resolution of a collateral matter.

Cohen is distinguishable.[17] First, the state courts have not completed their work on Raytheon's motion under Insurance Code § 1616. It has yet to be determined

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[17] While *Cohen* involves an interpretation of the concept of "finality" under 28 U.S.C. § 1291, this Court has sanctioned reliance on § 1291 cases when analyzing finality under § 1257.

whether some or all of the petitioners will purge themselves of the trial court's existing order by obtaining admission to transact insurance in California. Second, as for those insurers who do not secure admission, the state trial court has yet to determine the amount of the bond. That will only be done after certain discovery is completed and another hearing is held.

In short, petitioners do not satisfy the first of the tests of finality set out in *Cohen*. The state courts have not yet completed their disposition of Raytheon's motion under Insurance Code § 1616. Petitioners cite no case conferring finality on an order that leaves unresolved the amount of the bond, and also leaves a litigant a possible avenue to avoid the bonding requirement altogether. By contrast, *Cohen* finally disposed of the issue of security by denying any security.

The narrow *Cohen* exception to the final judgment rule ought not be widened. A widening would encourage premature certiorari petitions in cases where the amount of security is open. This Court should not be asked to consider constitutional questions when the lower courts are still crafting their orders and still settling the consequences that flow from those orders.

Jurisdiction is doubtful for another reason. Even in cases where the lower courts have completely disposed of an issue concerning prejudgment security, *Cohen* does not automatically confer "finality." Since *Cohen*, several cases have suggested that orders *requiring* security to be posted are less prone to be collateral orders under *Cohen*. There

is reason to limit *Cohen* to orders *denying* a request for security. As the Sixth Circuit has written:

> The issue of whether prejudgment security devices are immediately appealable under Cohen has been extensively litigated. The courts of appeals have uniformly held that orders granting such security are not immediately appealable under Cohen, reasoning that there is no risk of important loss if prejudgment security is granted since the interest of both parties is adequately protected.

Hitachi Zosen Clearing, Inc. v. Tek-Matik, Inc., 846 F.2d 27, 28 (6th Cir. 1988).

CONCLUSION

The petition for writ of certiorari should be denied.

DATED: December 13, 1995

Respectfully submitted,

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SELECTED PORTIONS
OF THE
CALIFORNIA INSURANCE CODE

§ 700. Certificate of Authority to Transact Business; Compliance; Violation

(a) A person shall not transact any class of insurance business in this state without first being admitted for that class. Admission is secured by procuring a certificate of authority from the commissioner. The certificate shall not be granted until the applicant conforms to the requirements of this code and of the laws of this state prerequisite to its issue.

(b) The unlawful transaction of insurance business in this state in willful violation of the requirement for a certificate of authority is a public offense punishable by imprisonment in the state prison, or in a county jail not exceeding one year, or by fine not exceeding one hundred thousand dollars ($100,000), or by both, and shall be enjoined by a court of competent jurisdiction on petition of the commissioner.

(c) After the issuance of a certificate of authority, the holder shall continue to comply with the requirements as to its business set forth in this code and in the other laws of this state.

* * *

§ 703. Acts constituting misdemeanors

Except when performed by a surplus line broker, the following acts are misdemeanors when done in this State:

(a) Acting as agent for a nonadmitted insurer in the transaction of insurance business in this State.

(b) In any manner advertising a nonadmitted insurer in this State.

(c) In any other manner aiding a nonadmitted insurer to transact insurance business in this State.

In addition to any penalty provided for commission of misdemeanors, a person violating any provision of this section shall forfeit to this State the sum of five hundred dollars, together with one hundred dollars for each month or fraction thereof during which he continues such violation.

ARTICLE 4

ACTIONS AGAINST NONADMITTED INSURERS

§ 1610. Commissioner's Automatic Appointment as Attorney; Service of Process
§ 1611. Actions Requiring Commissioner's Appointment
§ 1612. Service of Process
§§ 1613-1615. Repealed
§ 1616. Requirements Before Filing of Pleading
§ 1617. Postponement for Defense and Compliance
§ 1618. Motion to Quash or Set Aside Service
§ 1619. Irritating Refusal to Pay Claim; Attorney's Fee
§ 1620. Applicability When Attorney Resident of State; Maintenance of Sufficient Securities or Filing of Bond

§ 1610. Commissioner's Automatic Appointment as Attorney; Service of Process

Any of the acts described in Section 1611, when effected in this State, by mail or otherwise, by a foreign or alien insurer which is nonadmitted at the time of the solicitation, issuance or delivery by it of contracts of insurance to residents of, or to corporations authorized to do business in, this State, is equivalent to and shall constitute an appointment by such insurer of the commissioner and his successor or successors in office to be its true and lawful attorney, upon whom may be served all lawful process in any action, suit or proceeding instituted

by or on behalf of an insured or beneficiary arising out of any such contracts of insurance, and any such act shall be signification of its agreement that such service of process is of the same legal force and validity as personal service of process in this State upon such insurer.

§ 1611. Actions Requiring Commissioner's Appointment

The acts referred to in Section 1610 are:

(1) The issuance or delivery to residents of, or to corporations authorized to do business in, this State of contracts of insurance insuring (a) the lives or persons of residents of this State physically present herein at the time of such issuance or delivery or (b) property or operations located in this State.

(2) The solicitation of applications for such contracts.

(3) The collection of premiums, membership fees, assessments or other considerations for such contracts.

(4) Any other transaction of business arising out of such contracts.

§ 1612. Service of Process

Such service of process may be made as provided in Article 1 (commencing with Section 12919) of Chapter 2 of Division 3.

* * *

§ 1616. Requirements Before Filing of Pleading

Before any nonadmitted foreign or alien insurer shall file or cause to be filed any pleading in any action, suit or proceeding instituted against it, the insurer shall either (1) procure a certificate of authority to transact insurance in this state; or (2) give a bond in the action, suit or proceeding in an amount to be fixed by the court sufficient to secure the payment of any final judgment which may be rendered in the action, suit, or proceeding.

§ 1617. Postponement for Defense and Compliance

The court in any action, suit, or proceeding, in which service of process is effected in the manner provided in Section 1612 may, in its discretion, order such postponement as may be necessary to afford the defendant reasonable opportunity to comply with the provisions of Section 1616 and to defend such action.

§ 1618. Motion to Quash or Set Aside Service

Nothing in Section 1616 is to be construed to prevent a nonadmitted foreign or alien insurer from filing a motion to quash a writ or to set aside service thereof made in the manner provided in Section 1612 on the ground that such insurer has not done any of the acts described in Section 1611.

§ 1619. Irritating Refusal to Pay Claim; Attorney's Fee

In any action against a nonadmitted foreign or alien insurer upon a contract of insurance issued or delivered in this State to a resident thereof or to a corporation

authorized to do business therein, if the insurer has failed for 30 days after demand prior to the commencement of the action to make payment in accordance with the terms of the contract, and it appears to the court that such refusal was vexatious and without reasonable cause, the court may allow to the plaintiff a reasonable attorney fee and include such fee in any judgment that may be rendered in such action. Such fee shall not exceed 12-1/2 percent of the amount which the court or jury finds the plaintiff is entitled to recover against the insurer, but in no event shall such fee be less than twenty-five dollars ($25). Failure of an insurer to defend any such action shall be deemed prima facie evidence that its failure to make payment was vexatious and without reasonable cause.

§ 1620. Applicability When Attorney Resident of State; Maintenance of Sufficient Securities or Filing of Bond

(a) The provisions of the preceding sections of this article shall not apply to any action, suit or proceeding against any unauthorized foreign or alien insurer arising out of any contract of insurance effected in accordance with Sections 1760.5 and 1763 where such contract contains a provision designating a resident of this state or any firm of which one member is a resident of this state to be its true and lawful attorney upon whom may be served all lawful process in any such action, suit or proceeding.

(b) In any such action, suit or proceeding arising out of any such contract of insurance, the court may require the insurer to file a bond, in an amount sufficient

to secure the payment of any final judgment which may be rendered unless the insurer makes a showing satisfactory to the court that it maintains in a state of the United States funds or securities in trust or otherwise, sufficient and available to satisfy any such final judgment and that it will pay the judgment without requiring suit to be brought thereon in the state where the securities or funds are located.

CHAPTER 6

SURPLUS LINE BROKERS

§ 1760. Who May Deal with Nonadmitted Insurer
§ 1760.5 Applicability of Chapter; Procedure for Special Lines Surplus Line Broker License; Reports; Penalty for Violation
§ 1761. Insurance to Be Placed with Nonadmitted Insurer Only Through Surplus Line Broker
§ 1762. Repealed
§ 1763. Conditions Precedent to Placing Insurance with Nonadmitted Insurer
§ 1763.5. Conditions Precedent to Placing Insurance with Nonadmitted Insurer-Automobile Assigned Risk Coverage
§ 1764. Certificates Evidencing Placement of Insurance with Nonadmitted Insurer
§ 1764.1. Policy Issued by Nonadmitted Insurer; Mandatory Disclosure Statement
§ 1764.2 Requirements Before Issuance of Certificate
§ 1764.3. Delivery of Insurance Policy
§ 1764.4. Authentication of Policy Documents; Obligation Joint or Several
§ 1764.5. Insurance Subject to Cancellation for Violation
§ 1764.6 Reserved
§ 1764.7. Violation Is Public Offense
§ 1765. Requirements for Application and Renewal of License; Fees
§ 1765.1. Coverage Can Be Placed by Surplus Line Broker with Nonadmitted Insurer in Certain

Cases – Evidence of Financial Stability – Foreign Insurer – Documents Produced – Removal from List of Eligible Surplus Line Insurers – Fees – Definitions
§ 1765.2. Requirements of Corporation for Surplus Line Broker's License
§ 1765.3. Proving Competency to Be Licensed
§ 1765.4. Conditions for Automatic Denial of License
§ 1766. Premium Paid to Surplus Line Broker Deemed Paid to Insurer
§ 1767. Report of Broker's Offices in State; Addresses and Principal Office
§ 1768. Maintenance of Records
§ 1769. List of Admitted Insurers Refusing Insurance
§ 1770. Examination of Broker's Affairs by Commissioner
§ 1771. Payment of Examination Expense
§ 1772. Suits Involving Surplus Line Brokers – Remedies
§ 1773. Repealed
§ 1774. Filing and Contents of Annual Statement
§ 1775. Reports and Statements Made on Blanks
§ 1775.1. Quarterly Installments of Annual Tax; Exception
§ 1775.2. Notice and Forms for Quarterly Tax Installments
§ 1775.3. Time and Procedure for Making Quarterly Tax Installments

§ 1775.4. Computation of Quarterly Tax Installments; Penalty for Untimely Payments; Extensions
§ 1775.5. Determination of Annual Gross Premium Tax; Penalty for Untimely Payments; Extensions
§ 1775.6. Procedure for Transmission of Funds to State Treasury
§ 1775.7. Appropriation of Funds
§ 1776. Violations and Penalties
§ 1776.8. Payment of Taxes by Electronic Funds Transfer
§ 1777. Repealed
§ 1778. Conditions for New License After Revocation
§ 1779. Examination of Documents; Penalty for Refusal
§ 1780. Notification of Change of Address

§ 1760. Who May Deal with Nonadmitted Insurer

(a) Any person may negotiate and effect insurance to protect himself, herself, or itself against loss, damage, or liability with any nonadmitted insurer.

(b) Every person that effects insurance governed by this chapter shall pay the tax imposed by Part 7.5 (commencing with Section 13201) of Division 2 of the Revenue and Taxation Code.

§ 1761. Insurance to Be Placed with Nonadmitted Insurer Only Through Surplus Line Broker

Except as provided in Sections 1760 and 1760.5, a person within this State shall not transact any insurance

on property located or operations conducted within, or on the lives or persons of residents of this State with nonadmitted insurers, except by and through a surplus line broker licensed under this chapter and upon the terms and conditions prescribed in this chapter.

* * *

§ 1763. Conditions Precedent to Placing Insurance with Nonadmitted Insurer

(a) A surplus line broker may solicit and place insurance, other than as excepted in Section 1761, with nonadmitted insurers only if that insurance cannot be procured from insurers admitted for the particular class or classes of insurance and that actually write the particular type of insurance in this state. Each surplus line broker shall be responsible to ensure that a diligent search is made among insurers that are admitted to transact and are actually writing the particular type of insurance in this state before procuring the insurance from a nonadmitted insurer. Each surplus line broker shall file with the commissioner or his or her designee, within 60 days of placing any insurance with a nonadmitted insurer, a written report, that shall be kept confidential, regarding the insurance. This report shall include the name and address of the insured, the identity of the insurer or insurers, a description of the subject and location of the risk, the amount of premium charged for the insurance, a copy of the declarations page of the policy or a copy of the surplus line broker's certificate or binder evidencing the placement of insurance, and other pertinent information that the commissioner may reasonably require. In addition, each surplus line broker shall file a

standardized form to be prescribed by the commissioner setting forth the diligent efforts to place the coverage with admitted insurers and the results of these efforts. The form shall be signed by a person licensed under this code who has made the diligent search required by this section or who supervised an unlicensed person or persons who actually conducted the search. The insurance shall not be placed with a nonadmitted insurer for the purpose of procuring a rate lower than the lowest rate that will be accepted by any admitted insurer except as provided by subdivision (c). The commissioner may make and publish reasonable rules and regulations, consistent with this chapter, in respect to transactions governed thereby and the basis or bases for his or her determinations hereunder.

(b) It shall be prima facie evidence that a diligent search among admitted insurers has been made if the standardized form filed as required by subdivision (a) establishes that three admitted insurers that actually write the particular type of insurance in this state have declined the risk, or that fewer than three admitted insurers actually write the particular type of insurance. The commissioner, or his or her designee, may review the form for the accuracy of the information provided on it, including, but not limited to, whether the listed insurers actually write that type of insurance, and whether the three insurers declined the risk. The commissioner may take disciplinary action against the person signing the form for any misrepresentation made in the form due to the negligence of or the result of an intentional act by that person or the person or persons who actually conducted

the search. Those actions may include any action authorized to be taken against a licensed person by this code. Nothing in this subdivision shall preclude the commissioner or his or her designee from directing the surplus line broker to conduct a further or additional search among admitted insurers for similar placements in the future.

(c) It shall be conclusively presumed that insurance is placed in violation of this section if the insurance is actually placed with a nonadmitted insurer at a lower rate of premium or lower premium than the lowest rate of premium or the lowest premium that could be obtained from an admitted insurer unless, at the time the insurance attaches, there is filed with the commissioner a statement describing the insurance, specifying the rate and the nearest procurable rates from admitted insurers. The statement shall include an explanation of the reasons that the insurance must be placed with a nonadmitted insurer even though it is available from an admitted insurer. Unless the commissioner, or his or her designee, within five days after that filing notifies the filing broker that in his or her opinion the placing of the insurance constitutes a violation of this section, the broker may thereafter maintain in effect that insurance. If within that five-day period the commissioner notifies the surplus line broker that the insurance is in violation of this section and orders the broker to effect termination of that insurance within 10 days from the notice, and the broker fails or refuses to effect that termination, that failure or refusal is a violation of this section.

(d) Statements filed under this section are not subject to public inspection unless the commissioner determines that the public interest or the welfare of the filing broker requires that any statement be made public.

(e) For purposes of this section, "type of insurance" means the hazard or combination of hazards covered by a contract of insurance.

(f) Notwithstanding subdivision (a), this section shall not apply to insurance issued or delivered in this state by a nonadmitted Mexican insurer by and through a surplus line broker affording coverage exclusively in the Republic of Mexico on property located temporarily or permanently in, or operations conducted temporarily or permanently within, the Republic of Mexico.

§ 1764. Certificates Evidencing Placement of Insurance with Nonadmitted Insurer

A licensed surplus line broker may issue certificates evidencing the placement of insurance with a nonadmitted insurer. Such certificates shall be in the name of such surplus line broker and not in the name of such nonadmitted insurer, and shall contain all of the matters specified in Insurance Code Section 381.

§ 1765. Requirements for Application and Renewal of License; Fees

(a) A license under this chapter shall be applied for and renewed by the filing with the commissioner of a written application therefor, in accordance with the provisions of Section 1652.

(b) Subject to subdivision (f) of this section, the commissioner shall issue a license authorizing any applicant who is trustworthy and competent to transact an insurance brokerage business in such manner as to safeguard the interest of the insured, to act as a surplus line broker from the date of the license until the expiration date specified in Section 1630.

(c) An applicant for a surplus line broker's license shall, as part of the application and a condition of the issuance of the license, file a bond to the people of the State of California in the sum of fifty thousand dollars ($50,000), conditioned that the licensee will fully and faithfully comply with the requirements of this chapter, and all applicable provisions of this code. The bond shall be subject to the provisions of Sections 1662 and 1663.

(d) The filing fee for a license to act as a surplus line broker, and naming up to two natural persons on the license, shall be two hundred ninety-five dollars ($295) per year, or for any initial fractional license year. If more than two natural persons are named on the license, an additional fee of eighty-three dollars ($83) per year, or for any initial fractional license year, shall be paid for each additional natural person named on the license.

(e) Such license shall be renewed in accordance with and subject to, the provisions of Sections 1717, 1718, 1719, and 1720.

(f) The commissioner may deny, suspend or revoke any license applied for or granted pursuant to this chapter on all or any one of the grounds and in accordance with the procedures provided in Article 6 (commencing

with Section 1666) and Article 13 (commencing with Section 1737) of Chapter 5, whenever the commissioner finds that the applicant or licensee has committed a violation of any provision of this code.

§ 1768. Maintenance of Records

Such broker shall keep in this state complete records of the business transacted by him with nonadmitted insurers under his license as a surplus line broker. After notice and hearing, the commissioner shall promulgate reasonable rules and regulations specifying the manner and type of records to be maintained by surplus line brokers and the location or locations where such records shall be kept.

§ 1769. List of Admitted Insurers Refusing Insurance

Whenever required so to do by the commissioner, such surplus line broker shall furnish to the commissioner a list of the admitted insurers from which the entire amount of insurance desired was not obtainable.

§ 1770. Examination of Broker's Affairs by Commissioner

The commissioner, whenever he deems necessary, may examine the books and accounts of any surplus line broker for the purpose of determining whether or not the broker is conducting his business in accordance with the provisions of this chapter. For the purpose of making such examination such broker shall allow the commissioner free access at all times to all the broker's books

and papers, and the commissioner shall thoroughly inspect and examine all of the broker's affairs.

§ 1774. Filing and Contents of Annual Statement

On or before the first day of April of each year the surplus line broker shall file with the commissioner a sworn statement of all business transacted under his license during the last preceding calendar year. Such statement shall contain accounts of the gross premiums received and return premiums, separately stated.

§ 1775.5. Determination of Annual Gross Premium Tax; Penalty for Untimely Payments; Extensions

Every surplus line broker shall annually, on or before the first day of April of each year pay to the Insurance Commissioner for the use of the State of California a tax of 3 percent of the gross premiums upon business done by him under authority of his license during the preceding calendar year, less 3 percent of return premiums paid by him in that year by reason of cancellation or reduction of premium, excluding gross premiums paid and return premiums paid by him upon business governed by the provisions of Section 1760.5. If during any calendar year 3 percent of such return premiums paid by a surplus line broker exceed 3 percent of the gross premiums upon such business done by him in that year, then he may either carry forward such excess to the next succeeding year and apply it as a credit against 3 percent of gross premiums on such business done by him in such succeeding year, or he may elect to receive, and thereupon be paid a refund equal to the amount of taxes theretofore paid by

him on such excess of return premiums paid over gross premiums received.

For the purpose of determining such tax, the total premium charged for all such nonadmitted insurance placed in a single transaction with one underwriter or group of underwriters, whether in one or more policies, shall be allocated to this state in such proportion as the total premium on the insured properties or operations in this state, as computed on the exposure in this state on the basis of any single standard rating method in use in all states or countries where such insurance applies, bears to the total premium so computed in all states or countries in which such nonadmitted insurance may apply. This provision shall not apply to interstate motor transit operations conducted between this and other states. With respect to such operations surplus line tax shall be payable on the entire premium charged on all nonadmitted insurance, less

A. Such portion of the premium as is determined, as herein provided, to have been charged for operations in other states taxing such premium on operations in such states of an insured maintaining its headquarters office in this state;

B. The premium for any operations outside of this state of an insured who maintains a headquarters operating office outside of this state and a branch office in this state.

A penalty of 10 percent of the amount of the payment due shall be levied upon and paid by any surplus line broker who fails to make the necessary payment within the time required, plus interest at the rate of 1 percent per

calendar month or fraction thereof, from April 1, the due date of the annual tax, until the date the payment is received by the commissioner. The commissioner, upon a showing of good cause, may extend for not to exceed 30 days, the time for filing a tax return or paying any amount required to be paid with the return. The extension may be granted at any time, provided that a request therefor is filed with the commissioner within, or prior to, the period for which the extension may be granted.

Any surplus line broker to whom an extension is granted shall, in addition to the tax, pay interest at the rate of 1 percent per month or fraction thereof from April 1, until the date of payment. The commissioner may remit the penalty in a case where the commissioner finds, as a result of examination or otherwise, that the failure of or delay in payment arose out of excusable mistake or excusable inadvertence.

For any part of a payment required by this section or by Section 1775.4 which was not made within the time required by law, when such nonpayment or late payment was due to fraud on the part of the broker, a penalty of 25 percent of the amount unpaid shall be added thereto, in addition to all other penalties otherwise imposed.

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Supreme Court, U.S.
FILED
DEC 21 1995
CLERK

No. 95-601

In The
Supreme Court of the United States

OCTOBER TERM, 1995

LOWSLEY-WILLIAMS AND COMPANIES, ET AL.,
PETITIONERS

v.

RAYTHEON COMPANY,
RESPONDENT

On Petition for a Writ of Certiorari to the
California Court of Appeal,
First Appellate District, Division Five

PETITIONERS' REPLY TO BRIEF IN OPPOSITION

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26 pp

RULE 29.6 LIST OF CORPORATE PARTIES' PARENT COMPANIES AND SUBSIDIARIES

Pursuant to Rule 29.6 of the Rules of the Supreme Court of the United States, a listing of parent and nonwholly owned subsidiaries of each of the corporate petitioners is set forth at App. 101a-111a of the Petition for a Writ of Certiorari.

TABLE OF CONTENTS

Page

RULE 29.6 LIST OF CORPORATE PARTIES' PARENT COMPANIES AND SUBSIDIARIES i

I. THE COURT OF APPEAL'S OPINION HAS BEEN WIDELY CITED AND RELIED UPON BY OTHERS. 1

II. THE COURT OF APPEAL OPINION'S DEVASTATING IMPACT IS BROAD, AS IT AUTHORIZES USE OF THE PRE-ANSWER BOND TACTIC WHENEVER A MULTI-STATE RISK IS INVOLVED. 2

III. THE CONSTITUTIONAL ISSUE WAS PRESERVED. 5

IV. PETITIONERS HAD A PROTECTIBLE PROPERTY INTEREST IN TRANSACTING SURPLUS LINE INSURANCE BUSINESS WITH RAYTHEON AND OTHER FORTUNE 500 COMPANIES. 6

V. THE COURT OF APPEAL'S RULING BELOW WAS AN UNFORESEEABLE DEPARTURE FROM THE EARLIER, CONSISTENT POSITION OF THE DEPARTMENT OF INSURANCE. 7

CONCLUSION 10

APPENDIX A

California Department of Insurance

Amicus Letter Brief 1a

APPENDIX B

Prometheus Funding Corp. (f.k.a. Frank

B. Hall & Co., Inc.) Amicus Letter 8a

TABLE OF AUTHORITIES

CASES

Page(s)

Demorest v. City Bank Farmers Trust Co.,
321 U.S. 36, 42 (1944) 9

Dillion v. City of Chicago,
866 F.2d 902, 905 (7th Cir. 1988) 5

Memphis Light, Gas & Water Div. v. Craft,
436 U.S. 1, 9 (1978) 9

Mid-American Indemnity Ins. Co. v. King,
38 Tex. Sup. Ct. J. 1018, 1995 WL
407388 (Tex. 1995) 4

Texaco Inc. v. Pennzoil,
784 F.2d 1133, 1138 (2nd Cir. 1986)
rev'd on other grounds,
481 U.S. 1 (1987) 4

Trihedron Internat. Assurance, Ltd. v. Superior Court,
218 Cal. App. 3d 934, 267 Cal. Rptr.
418 (1990) 3

United States v. Pennsylvania Indust. Chem. Corp.,
411 U.S. 655, 674 (1973) 8

Whitcomb Hotel, Inc. v. California Employment Commission,
24 Cal. 2d 753, 756-57, 151 P.2d 233,
235 (1944) 8

STATUTES

California Insurance Code § 35 7
California Insurance Code § 699 6
California Insurance Code § 700 7
California Insurance Code § 700(a) 6
California Insurance Code § 1611 7
California Insurance Code § 1616 . . . . . 1, 8
California Insurance Code § 1761 7

MISCELLANEOUS

Hart and Wechsler's The Federal Courts and the Federal System 579 (3d ed. 1988) 9

PETITIONERS' REPLY TO BRIEF IN OPPOSITION

The petition presents a fundamental due process question of whether a "bond or additional license" requirement, which Raytheon concedes to be "onerous" (R 902), can be imposed on insurers as a pre-condition to being allowed to defend themselves in litigation. An additional issue, disputed by Raytheon in its opposition, is whether issuance of policies in a manner that was consistent with the California Insurance Commissioner's interpretation and enforcement of California insurance requirements, and not inconsistent with any pre-existing California statute, regulation, or court decision, gave rise to a protectible property interest. Both are issues that lie at the heart of the Fourteenth Amendment and are appropriately before this Court.

I. THE COURT OF APPEAL'S OPINION HAS BEEN WIDELY CITED AND RELIED UPON BY OTHERS.

Raytheon previously argued that the Court of Appeal's opinion in this case should be published because "the constitutionality of Ins. Code § 1616 'involves a legal issue of continuing public interest...'." *See*, Raytheon's May 10, 1995 letter to Court of Appeal.

Despite the denial of Raytheon's request, the opinion repeatedly has been cited by other corporate policyholders that seek to use the pre-answer bond statutes in high-stakes pollution coverage litigation. The opinion has been cited by Lockheed in its $475 million pre-answer bond motion and by Exxon in its $850 million pre-answer bond motion. Even Raytheon's counsel have cited the opinion in other pollution coverage cases brought by them

on behalf of Tosco Corporation and Potlatch Corporation.

II. THE COURT OF APPEAL OPINION'S DEVASTATING IMPACT IS BROAD, AS IT AUTHORIZES USE OF THE PRE-ANSWER BOND TACTIC WHENEVER A MULTI-STATE RISK IS INVOLVED.

Before the Court of Appeal's opinion in this case, pre-answer bond statutes were rarely, if ever, used. Raytheon has never cited any California case applying the statute when the policies had been placed through a surplus line broker.[1/]

By 1984, when Raytheon hired Frank B. Hall of Massachusetts[2/] to obtain the involved insurance policies,[3/] and

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[1/] Although Raytheon suggests that "[t]he lower courts have consistently held such statutes to be constitutional," it cites no cases in support of that statement and appears to refer only to *Trihedron*, which involved no surplus line broker, and *Mid-American*.

[2/] The Court of Appeal found that Raytheon "hired" as its insurance broker Frank B. Hall of Massachusetts. (App. 12a) Under the Court of Appeal's analysis, a pre-answer bond is required because Raytheon selected a broker licensed in Massachusetts and chose to sue in California. Had Raytheon selected another Frank B. Hall subsidiary, Frank B. Hall of California, which was licensed in California (R 623, 701), or selected Massachusetts as the litigation forum, the onerous pre-answer bond requirement would not be available to Raytheon. This circumstance is what caused the trial court to question whether there was not "something wrong" and to comment that "usually the law makes sense." (R 903) It also relates to what the Court of Appeal dismissed as a "necessary evil of federalism" and "regulatory Balkanization." (App. 24a) In fact, the "evil" was created by the Court of Appeal's unexpected departure from the position of the California Department of Insurance -- and then its decision to ignore the position of the California Department of Insurance.

[3/] Raytheon complains that it does not have California Insurance Guarantee Association protection because Petitioners are not admitted insurers. Yet the Court of Appeal found that "the additional excess coverage requested by Raytheon was not available from insurers admitted to transact insurance in the State of

when those policies were negotiated and issued to Raytheon in its home state, Massachusetts, no California appellate court had ever applied the California pre-answer bond statutes -- despite the passage of 35 years since their enactment.

By 1993, when Raytheon made its pre-answer bond motion, only one California appellate court had addressed the application of the pre-answer bond statute. The statute was applied to require a bond from a rogue Caribbean insurer, which had illegally transacted insurance in California without the involvement of any surplus line broker. *See, Trihedron Internat. Assurance, Ltd. v. Superior Court*, 218 Cal. App. 3d 934, 267 Cal. Rptr. 418 (1990).

No California appellate opinion before the appellate opinion in this case had ever applied the pre-answer bond statutes to an insurance transaction, similar to the involved transactions, where the transaction conformed to all regulatory requirements of the California Department of Insurance. As the California Department of Insurance *amicus curiae* letter (reprinted as an attachment) notes, this case differs from the *Trihedron* case because it "involved no surplus line broker." (Reply App. 6a)

London Market insurers for decades have provided insurance to America's Fortune 500 companies, including companies identified in earlier briefs, such as Shell Oil, ARCO,

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State of Massachusetts." (App. 12a) Raytheon, through its agent, Hall, knew that it was not purchasing insurance from an admitted insurer and knew that it was not obtaining insurance protected by a state guarantee fund. Such insurance "was not available."

Texaco, Union Oil, Lockheed, Martin-Marietta and FMC Corporation. As virtually all Fortune 500 companies have multi-state operations, London Market insurers have operated in reliance on "the position of the [California] Department of Insurance, communicated to the industry, that a multi-state risk negotiated and placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements." (App. 33a-34a) Transactions involving billions of dollars of insurance premiums have been completed in reliance on this long-standing position of the California Department of Insurance and other state insurance departments.

Because the hard-fought pollution coverage litigation between Fortune 500 companies and their insurers involve long-expired multi-state risk insurance policies that were issued in the 1950s, 1960s, and 1970s in conformance with state insurance department positions regarding such transactions, the pre-answer bond statutes provide a tactic that has the potential to drive even the most solvent insurers to bankruptcy by requiring a forfeiture of the policyholder's premium payments to a surety and imposing a "freeze" of the insurers' assets as the result of surety collateral requirements.[4/] The ability to freeze assets has the potential of

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[4/] Within one month of the Texas Supreme Court's decision in *Mid-American Indemnity Ins. Co. v. King*, 38 Tex. Sup. Ct. J. 1018, 1995 WL 407388 (Tex. 1995), the insurer filed a bankruptcy petition, which stayed further proceedings in that action.

The Second and Seventh Circuit Courts of Appeal have recognized that bond requirements can have devastating financial effects. *Texaco Inc. v. Pennzoil*, 784 F.2d 1133, 1138 (2nd Cir. 1986) rev'd on other grounds, 481

creating a devastating "run-on-the-bank" financial failure.

III. THE CONSTITUTIONAL ISSUE WAS PRESERVED.

Raytheon argues that the constitutional issue was waived, yet the due process argument was raised in Petitioners' first brief filed in the trial court (R 429-436), and vigorously argued in every subsequent brief. The due process argument was never waived;[5/] indeed the Court of Appeal considered and rejected the argument. (App. 24a)

Petitioners also repeatedly asserted that these insurance transactions conformed to the requirements governing the placement of insurance (R 912; Writ Petition at pp. 25-27) and included that assertion in the "Issues Presented" in both petitions for review to the California Supreme Court. The Court of Appeal simply considered and rejected the argument. The fact that additional support from the California Insurance Commissioner was provided by the State's regulator after the Court of Appeal ruled that Petitioners should have "accounted themselves to the California Insurance Commissioner" (App. 21a) does not support any waiver argument, as Petitioners repeatedly had argued that the transaction had conformed to all applicable statutory requirements.

Finally, there was no waiver of the fundamental *Bell v.*

Dillion v. City of Chicago, 866 F.2d 902, 905 (7th Cir. 1988).

[5/] Petitioners did waive certain statutory interpretation issues about the scope of the pre-answer bond statutes, as the Court of Appeal noted in its opinion. (App. 17a-21a)

Burson argument, which was considered and rejected in the Court of Appeal's written opinion (App. 19a), with the statement that the argument had been "examined and rejected on our initial writ review." (App. 19a)

IV. PETITIONERS HAD A PROTECTIBLE PROPERTY INTEREST IN TRANSACTING SURPLUS LINE INSURANCE BUSINESS WITH RAYTHEON AND OTHER FORTUNE 500 COMPANIES.

Certain Underwriters at Lloyd's, London and London Market insurance companies for decades have provided insurance to America's Fortune 500 companies. Raytheon now questions whether, under the Fourteenth Amendment, Petitioners had a protectible interest in issuing insurance policies generating billions of dollars of insurance premiums in a manner that conformed to the position of the California Department of Insurance.

The California Insurance Commissioner, as confirmed by a letter brief in this action, previously had communicated to the industry that Petitioners were not required to be admitted California insurers. No statute, regulation, or California case law in existence at the time the policies were issued contradicted the Department's position. In fact, by statute, those Petitioners who are Lloyd's underwriters could not be admitted California insurers. Cal. Ins. Code § 699. And, as Raytheon acknowledges, admission is required under section 700(a) of the California Insurance Code only if Petitioners, at the time the policies were issued, transacted insurance "in this state."

Because surplus line requirements are merely an exception

to California's admission requirements set forth in section 700, the surplus line requirements logically would not apply to transactions not subject to section 700. This is confirmed by section 1761, which requires the involvement of a California-licensed surplus line broker only for transactions "within this state." At the time the policies were issued, the only acts encompassed within the section 35 statutory definition of "transact" occurred *outside* the state.[9] The California Court of Appeal specifically found that the insurance negotiations and the policy issuance occurred "outside the State of California." (App. 12a)

Petitioners justifiably relied on the statutory language and the Department of Insurance's communications to the industry to conclude that they had a right to issue the policies to Raytheon through Raytheon's Massachusetts-licensed broker.

V. THE COURT OF APPEAL'S RULING BELOW WAS AN UNFORESEEABLE DEPARTURE FROM THE EARLIER, CONSISTENT POSITION OF THE DEPARTMENT OF INSURANCE.

The policies at issue were lawfully placed in conformance with the statutory requirements as interpreted and enforced in 1984

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[9] Raytheon refers to another section, section 1611, which by its language is limited to defining, not the "transaction" of insurance that already was defined in section 35, but the acts that are deemed to constitute the appointment of the insurance commissioner as agent for service of process. No court prior to the issuance of the involved policies had ever referred to section 1611 as defining what constituted the transaction of insurance in California or had ever suggested that an out-of-state transaction would be considered a California transaction for purposes of regulating the negotiation and issuance of the policies simply because a corporate policyholder had some of its operations in California.

by the California Department of Insurance. Petitioners "negotiated and placed" a multi-state risk insurance policy "outside of California" through Raytheon's agent, Frank B. Hall & Co. of Massachusetts, Inc. ("Hall"), who acted "under the authority of" a Massachusetts surplus line broker's license. (App. 12a) The policies at issue conformed with the requirements imposed by the California Department of Insurance[7/] -- the only legal authority available to Petitioners at the time the policies were issued.

Petitioners were justified in relying on the California Department of Insurance's legal position. *See, United States v. Pennsylvania Indust. Chem. Corp.*, 411 U.S. 655, 674 (1973). And because the Department's position was consistent with the governing statutes and relied upon by the industry in issuing countless insurance policies to Fortune 500 companies, the Court of Appeal should have accorded great weight to the Department's position regarding the legality of the transaction. *See, Whitcomb Hotel, Inc. v. California Employment Commission*, 24 Cal. 2d 753, 756-57, 151 P.2d 233, 235 (1944).

Property interests are created by state law, but "federal

[7/] Furthermore, although Petitioners were precluded by operation of section 1616 from conducting formal discovery, Frank B. Hall (now known as Prometheus Funding Corp.) submitted a letter to the Court of Appeal shortly after the California Supreme Court transferred the case back to the Court of Appeal -- and long before the Court of Appeal's decision -- confirming that were formal discovery permitted, it "would demonstrate that [Frank B. Hall & Co. of Massachusetts] fully complied with the requirements of the surplus lines laws of Massachusetts ...." (Reply App. 9a) Raytheon's suggestion that review of this issue can only occur on "a fully developed factual record" would permit the continued existence of a constitutional defect incapable of review since plaintiffs request pre-answer bonds before any responsive pleading has been filed or discovery has been permitted.

constitutional law determines whether that interest rises to a level of a 'legitimate claim of entitlement' protected by the Due Process Clause." *Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 9 (1978) (citations omitted). The California Department of Insurance, through its communications to the industry, created a protectible property interest for insurers, like Petitioners, who conformed to the Department's position on multi-state risk insurance. The Court of Appeal's opinion below was an unforeseeable retraction of this property interest. In addressing the federal constitutional issue, "it is the province of this Court to inquire whether the decision of the state court rests upon a fair or substantial basis." *Demorest v. City Bank Farmers Trust Co.*, 321 U.S. 36, 42 (1944). As Hart and Wechsler plainly imply, this Court should not consider itself bound by a state court's determination if it is "so aberrational or surprising that it subverts the purpose of the constitutional guarantee." *Hart and Wechsler's The Federal Courts and the Federal System* 579 (3d ed. 1988). As Raytheon points to no pre-1984 statute, regulation or court decision suggesting that Petitioners could not rely on the regulatory position of the California Department of Insurance, the record amply supports a determination that there was a property interest protectible under the Fourteenth Amendment.[9/]

[9/] Despite having blocked discovery and any hearing on the merits in the trial court, Raytheon now suggests that its claim might be covered because another insurer settled with Raytheon. But Raytheon ignores the pollution exclusions that operate to bar coverage. It also fails to describe that Continental settled to obtain a release not just of the 1984-1985 policies, but of 19 policies, which had liability limits in the aggregate many times the amount Continental paid.

CONCLUSION

This Court's *Bell v. Burson* holding compels the conclusion that when an insurer has issued an insurance policy in conformance with the regulatory requirements enforced by state regulators, the onerous "bond or additional license" requirement cannot subsequently be imposed as a pre-condition to the right to defend based on the mere fact that a claim has been made, without any inquiry into the merits of the claim.

The petition places before this Court the constitutionality of the pre-answer bond statutes that represent a devastating threat to Petitioners, to the eight-billion-dollar-per-year surplus line insurance market, and to the policyholders that have relied on the surplus line insurance market for both the payment of covered claims and the fulfillment of current insurance needs.

Respectfully submitted,

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APPENDIX

INDEX TO APPENDIXES

Page

APPENDIX A

California Department of Insurance Amicus Letter Brief 1a

APPENDIX B

Prometheus Funding Corp. (f.k.a. Frank B. Hall & Co., Inc.) Amicus Letter 8a

APPENDIX A

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May 10, 1995

Honorable J. Clinton Peterson, Presiding Justice
California Court of Appeal
First Appellate District, Division Five
Marathon Plaza, South Tower, Suite 600
303 Second Street
San Francisco, CA 94107-1369

RE: *Lowsley-Williams and Companies v. Superior Court (Raytheon Corporation)*
Court of Appeal, First Appellate Dist., Division Five
No. A063833,
San Francisco Superior Court No. 950755
Application of the California Department of Insurance For Leave To File Amicus Curiae Letter Brief In Support Of Petition For Rehearing; Brief

Dear Honorable Justice Peterson:

The California Department of Insurance requests leave to file an amicus curiae letter brief in this case in support of the petition for rehearing of petitioners Lowsley-Williams and Companies.

The Department of Insurance is familiar with the questions involved in this case and the scope of their presentation and believes that there is a necessity for additional argument on the following point: the legality of the placement of insurance on California property wherein the transaction took place in Massachusetts, with the insured being a Delaware corporation with its principal place of business in Massachusetts, having multi-state operations including the property in California, and the placement being made by a Massachusetts licensed surplus line broker using insurers not admitted in California.

The Department of Insurance believes that its input would be valuable to this Court because it is charged with the enforcement of the California Insurance Code, including regulating surplus line brokers in California (Insurance Code §§ 1760, et seq.). Inasmuch as the Department has been informed that the petitioners will be filing a petition for rehearing, the Department of Insurance hereby seeks permission to file a short letter brief as amicus curiae in the form as attached hereto.

Sincerely,

/s/

RICHARD F. FINN
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Attachment

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RE: *Lowsley-Williams and Companies v. Superior Court (Raytheon Corporation)*
Court of Appeal, First Appellate District, Division Five
No. A063833, San Francisco Superior Court No. 950755
Amicus Curiae Letter Brief In Support Of Petition For Rehearing

Dear Honorable Justice Peterson and Associate Justices:

This letter is respectfully submitted on behalf of the California Department of Insurance.

On April 25, 1995, this Court issued its decision in this

matter relating to provisions of the California Insurance Code. The issues concern the placement of insurance on California property owned by Raytheon. Raytheon, a Delaware corporation with its principal place of business in Massachusetts, transacted in Massachusetts with a Massachusetts licensed surplus line broker (not licensed in California) to obtain excess policy coverage on the California property with companies that are not admitted by the State of California to transact insurance within this state. The Court of Appeal decision (on page 12), determined that such insurance was "illegal." The California Department of Insurance, as amicus curiae, would like to address only this one point.

The Department of Insurance will specifically address that portion of the Court's decision beginning at page twelve, line nine, the sentence that opens with the word "furthermore":

> "Furthermore, the issuance of the policies in the present case is just as "illegal" as in *Trihedron*. By "illegal," Companies mean the policies were issued to California insureds by a nonadmitted insurer. That is exactly the case herein. Companies maintain that the case is different because they did not issue the policies directly but through a surplus line broker. Companies are correct that in general a nonadmitted insurer may issue insurance to California insureds without certification *if it does so through a bona fide, California licensed surplus line broker.* Companies are incorrect when they argue that by using a foreign broker not licensed in California, it may insure California persons or business operations without being admitted. Companies'

> position would allow such insurance to be issued with no regulatory oversight by this state, either by means of the admission process or by the licensing regulation of surplus line brokers." (This reference also includes footnote 12.)

In agreeing with and applying the law as set forth by the Fourth District Court of Appeal in *Trihedron Intern v. Superior Court* (1990) 218 Cal.App.3d 934, 267 Cal.Rptr. 418, this Court finds that there was a "California insurance transaction", as defined in *Trihedron* and Insurance Code section 1611, and that the "illegal" transaction of insurance has occurred. No citations are given for the conclusion that the transaction of insurance was "illegal" under the particular facts of this case, nor are any citations given for the conclusion that the transaction in this case may only issue "through a bona fide, California surplus line broker."

Amicus curiae Department of Insurance submits that the conclusion that the transaction was illegal unless through a California surplus line broker is in error. Insurance Code section 1761 provides in relevant part as follows:

> "Except as provided in sections 1760 and 1760.5, a person within this State shall not transact any insurance on property located ... within ... this State with nonadmitted insurers, except by and through a surplus line broker licensed under this chapter and upon the terms and conditions prescribed in this chapter."

It is the position of the Department of Insurance, communicated to the industry, that a multi-state risk negotiated and

placed outside of California under the authority of an insurance license issued by the state in which the placement is negotiated is not subject to California surplus line reporting requirements. The Department does not believe the multi-state risk placement involved in this case, which was negotiated in Massachusetts by a Delaware corporation (with its principal place of business in Massachusetts) and a Massachusetts-licensed surplus line broker, to be illegal under California law. This position has no conflict with the *Trihedron* decision, which involved no surplus line broker. However, this Court's "illegality" discussion appears to be in conflict with the Department of Insurance's position and could cause significant confusion in the industry should the decision become disseminated. That "illegality" discussion (the first full paragraph, including footnote 12, on page 12 of the slip opinion) is not necessary in reaching this Court's holding that a bond was required under Insurance Code section 1616.

For the foregoing reasons, it is requested that the petition for rehearing be granted or the opinion be modified to delete any reference to the transaction of insurance in this case having been "illegal".

DATED: May 10, 1995.

Respectfully submitted,

DANIEL E. LUNGREN
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/s/

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APPENDIX B

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August 16, 1994

To The Honorable Justices of the Court of Appeal of the State of California First Appellate District -- Division Five

RE: Lowsley-Williams v. San Francisco Superior Court
Raytheon Company, Real Party in Interest
A063833 San Francisco Superior Court No. 950755

Your Honors:

Prometheus Funding Corp. was formerly known as Frank B. Hall & Co. Inc., an international insurance services firm ("Frank B. Hall"). During the 1980's, Frank B. Hall's subsidiary, Frank B. Hall & Co. of Massachusetts, Inc. ("Hall/Massachusetts") acted as insurance broker for Raytheon. Hall/Massachusetts was merged into Frank B. Hall Insurance Brokers, Inc. in 1990 and the

operating assets of that company were sold to Aon Corp as of November 2, 1992. Frank B. Hall Insurance Brokers, Inc. is a subsidiary of Prometheus Funding Corp. and I am senior Vice President and Assistant Secretary of that company.

I have been informed that questions have arisen in this action regarding 1984-1985 insurance coverage placed by Hall/Massachusetts for Raytheon with Defendants Certain Underwriters at Lloyd's, London and London Market Insurance Companies ("London Insurance Defendants"). This letter will confirm that at the time this coverage was placed, Hall/Massachusetts was duly licensed as a surplus lines broker. This letter will also confirm that, if discovery were permitted, the discovery responses would demonstrate that Hall/Massachusetts fully complied with the requirements of the surplus lines laws of Massachusetts and that the appropriate surplus lines taxes were paid on the coverages placed with the London Insurance Defendants.

Respectfully submitted,

Peter J. Dranginis, Jr.

PJD/ae
L:Raytheon